UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

THE IMPACT OF FINANCIAL CRISIS ON TRADE, INVESTMENT AND DEVELOPMENT: REGIONAL PERSPECTIVES

High-level segment of the forty-fifth session of the Trade and Development Board
22 October 1998

UNITED NATIONS

TD/B/45/14

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Prepared by
UNCTAD Intergovernmental Support Services

UNITED NATIONS
New York and Geneva, 1999

Note

The statements in this book are edited versions of transcripts of the speeches made at the High-level Segment of the Trade and Development Board on 22 October 1998. Where no written statement was available, every effort has been made to have the edited transcript checked by the speaker. However, responsibility for the presentation of the statements lies solely with the UNCTAD secretariat.

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Acknowledgements

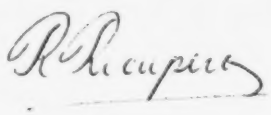
The text was edited by Paul Stephenson and desktop-published by Mary Chehab. The cover was designed by Diego Oyarzún-Reyes.

Preface

The Asian financial crisis of July 1997 has been – or should have been – a chastening experience for economists and decision makers the world over. It took them by surprise, it defied their initial analyses, and it refused to behave according to their predictions. At the High-level Segment of the Trade and Development Board in October 1998 there was general agreement that there is no single antidote to the continuing after-effects of the crisis, and no magic solution to prevent future financial crises. However, that does not mean we should be downhearted or passive! On the contrary, there is much we can do, in terms of improving regulatory procedures and burden-sharing arrangements for instance, to limit the "ripple effects" of the crisis, and to reduce the chances of a similar crisis taking us all by surprise a couple of years from now. There are also steps that can be taken to set up, or improve, social safety nets to ensure that the poorest and most vulnerable people have somewhere to turn when times are hard.

I am a firm believer in involving civil society in the work of UNCTAD, and I think that the discussions you will be reading in this book give ample evidence of the benefits of doing this. Simply put, some of the questions we have may be best answered by the people who have to deal with them every day. Why do investors put their money where they do? Ask an investor. How has the crisis been experienced by the enterprises, large and small, at the epicentre of the crisis? Ask the chief executive officers. Their answers to these questions provide valuable inputs to the intergovernmental debate, clarifying the issues for Governments, whose representatives also, as you will see, had many telling comments and suggestions of their own to make.

Of course, an excellent debate is one thing, but practical results are quite another. This book is part of UNCTAD's efforts to bridge that gap. It contains many very practical suggestions – some of which are highlighted for ease of reference – that we hope will be translated into action as this report of the High-level Segment is circulated in capitals throughout the world.



Rubens Ricupero
Secretary-General of UNCTAD

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Introduction

The **UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT** (UNCTAD), at its ninth session, held in Midrand, South Africa, from 27 April to 11 May 1996, adopted the *Midrand Declaration* and *A Partnership for Growth and Development*. In paragraph 107 (c) of *A Partnership for Growth and Development*, the Conference decided that the regular session of the Trade and Development Board should include "a segment ... to deal with a substantive policy item with a view to attracting high-level participation. Personalities from the public, private/business and academic sectors in areas related to UNCTAD's work should be invited to attend."

At the forty-fifth session of the Board, held in Geneva from 12 to 23 October 1998, the high-level segment was held on Thursday, 22 October 1998. The theme selected for the segment was "The impact of financial crisis on trade, investment and development: regional perspectives". The morning meeting, which was devoted to the Asian epicentre of the current financial crisis, began with presentations from six panellists – representatives of Asian businesses, a prominent trade unionist and the heads of two of the regional commissions of the United Nations. Their presentations were followed by an open debate. The afternoon meeting followed the same pattern, with panellists from the world of business and investment and from the regional commissions speaking on the "ripple effect" and lessons to be learned from the crisis. This session was held jointly with the Second Committee of the General Assembly in New York via a video conference link, a technique pioneered at the high-level segment of the forty-fourth session of the Board a year earlier.

Part I

The Asian epicentre

The high-level segment of the forty-fifth session of the Trade and Development Board was opened by H.E. Ambassador Chak Mun See (Singapore), President of the Trade and Development Board.

H.E. Mr. Supachai Panitchpakdi
Deputy Prime Minister of Thailand, Chairman of the High-level Segment

I wish first of all to express my deep appreciation to UNCTAD for the honour it has bestowed on me and my country by inviting me to chair the High-level Segment of this session of the Trade and Development Board. This event, which was established at UNCTAD IX as a forum for the high-level discussion of a substantive policy issue, is an example of UNCTAD's ability to change and to create new mechanisms through which to fulfil its development mission.

When the planning for this year's High-level Segment began more than nine months ago, it seemed to some that by October 1998 the topic chosen might no longer be a major, current issue. As it happens, the decision to discuss the impact of financial crisis on trade, investment and development has, unfortunately, proved to be a prophetic one because what started out as a regional financial crisis is rapidly becoming a global economic crisis, seemingly affecting countries indiscriminately, with sometimes devastating social consequences. Our meeting today therefore provides an opportunity for UNCTAD to make a valuable and timely contribution to the ongoing international dialogue on the causes of such crises and appropriate responses to them.

It would be naive to blame everything on globalization and liberalization; on the other hand, it would be equally unrealistic to ignore their role. For while these processes are irreversible, it is

now clear that no country is safe, even when its fundamentals are sound, because there are forces at work which are beyond the control of Governments. There is much talk about the systemic aspects of the problem; prescriptions also abound as to the national policy actions that need to be taken, but there is clearly no single remedy. In this context, expending energy on devising radical solutions – such as a retreat into autarky and protectionism or creating new international financial structures – is unlikely to facilitate agreement on workable remedies.

We must first seek to understand what is happening before attempting to reach some practical conclusions. Last week's discussion in the Trade and Development Board provided an assessment of the crisis from the perspective of Governments, including most of those who have been directly affected. Today, we have an opportunity to diagnose the crisis from the perspective of the world of business and finance, organized labour and the regional commissions of the United Nations.

MR. RUBENS RICUPERO
Secretary-General of UNCTAD

It is a great pleasure for me to be able to set the scene for what promises to be a very stimulating debate on a subject that goes to the heart of this organization's work. What we shall try to do here today is to add some value to the current debate on the Asian financial crisis: "to add value" in this context means to go beyond the discussions on the causes of the crisis or the blame to be apportioned for it, what Governments did or did not do, or what international organizations should do. In this session, the Trade and Development Board has already spent some time discussing the aspects of the crisis related to monetary and financial problems, the financial architecture and problems such as financial flows. Today our purpose is to hear from people who are really involved in this crisis. We have therefore invited a number of representatives of small, medium-sized and large companies in the countries originally affected to hear from them how they are coping

with problems such as the credit crunch, trade problems and the need to continue to invest in development, research, technology, innovation, etc. From their contributions, we hope to be able to extract some lessons for business people, government officials, those struggling to cope with the crisis and those in a position to give a helping hand. This is why we would like to take a closer look at technology flows, investment strategies, trade partners and, ultimately, employment in those regions.

As well as the actors who are directly involved, we also have with us today representatives of all five of the regional commissions of the United Nations, including the Executive Secretaries of four of them. All are men with considerable experience in their own regions, in government and in the private sector. It is essential that we bring the regional perspective into sharp focus, so that we can distinguish between the experiences of the different parts of the world and explain why and how they have differed. We hope that this will help us to be practical and down-to-earth.

As others have said before me, what we are facing today is the first real crisis of the globalized economy, and as President Clinton's exhortations about the urgent need for reform of the international machinery have underlined, concern over its impact on everyone's well-being has reached the highest levels.

What we hope to extract from this discussion is a clear message of the need to take prompt action, not only to allow the quick return of confidence in the case of countries already affected by the crisis, but also to stop the spread of its contagion effects. We are all called upon to show no fatalism or passivity in accepting the supposed inevitability of crisis. As a result of the growing problems in recent months, a very significant convergence of views has been taking place in all countries in the world. Now, for instance, we all agree that deflation, not inflation, is the real threat, and we all agree that we have to encourage economic growth, the growth of trade and the maintenance of open markets in order to create employment and to provide the world economy with the stimulus it needs. So we have reason to be confident that the world is moving in the right direction.

This morning, when I was driving here, I was glancing at the papers and I found another reason for this optimism. The debate among European nations is more and more turning its attention to the need to stimulate growth, cut interest rates further and stimulate spending by Governments in order to prevent the crisis from spreading to Europe. In recent days, we have also witnessed the decision by the United States Congress to provide the necessary funds for the IMF, and we have seen how the Japanese Parliament approved the Miyazawa Plan – which, by the way, a few days ago UNCTAD showed could have an enormous positive impact not only on Japan but on Asia in general and on the world economy – and we have seen the recent Federal Reserve Board's double cut in interest rates and many other signs that the international community is mobilizing in this positive direction.

As we face up to the first real crisis of the globalized economy, it is widely agreed that we have to encourage economic growth, the growth of trade, and the maintenance of open markets, in order to create employment and to stimulate the world economy

Let me conclude by saying that I hope that in this constructive spirit we will be able to extract some concrete pragmatic ideas from the experiences of people who are close to the problem and that these ideas will not only contribute to the ongoing debate here in UNCTAD but will also be a valuable input for Governments and for other international organizations. We are confident that when we meet for UNCTAD X in Bangkok in February of the year 2000, at the beginning of a new millennium and a new century, we will be meeting in a region in full recovery that will have proved that crisis can indeed be overcome if the right action is taken at the right time.

CHAIRMAN

Thank you very much, Mr. Secretary-General, for your thought-provoking remarks, which have set the tone for our discussion this morning on the topic of the Asian epicentre.

I would like to introduce to you our first panellist and speaker, Dato' Wan Malek Ibrahim, who is currently the Managing Director of Malaysia Airlines. He has an intimate knowledge of air transport, having previously started up a helicopter services company which is now quoted on the Kuala Lumpur Stock Exchange. The air transport sector has had to face considerable adjustment problems as a result of the financial crisis, with some Asian carriers fighting for their commercial survival. I would therefore like to invite Dato' Wan Malek Ibrahim to explain how Malaysia Airlines has responded to the crisis and to give us his view of the outlook for his company and for the air transport sector.

DATO' WAN MALEK IBRAHIM
Managing Director, Malaysia Airlines

I would like to begin by introducing my company, Malaysia Airlines. Malaysia Airlines is the national carrier of Malaysia, and has been in business for 50 years. We fly to all six continents in the world, we employ 23,000 people and we have a fleet of 100 aircraft, both big and small, including 747s and Airbuses. We were supposed to record our best-ever profit last year but unfortunately, because of this crisis, we recorded our worst-ever performance.

This morning's session is to focus on the East Asian epicentre of the financial crisis; to my mind, "epicentre" is an apt description of the origins of the crisis and the analogy with the effects of an earthquake is most appropriate. In an earthquake, the cities and provinces within the epicentre are bound to suffer the maximum impact in terms of human casualties and destruction of property. The devastating impact of this natural phenomenon, however, is

not limited to the epicentre. As we are all fully aware, the ripples of an earthquake can be felt thousands of kilometers away, causing panic and chaos among the population, and it takes time before the people feel safe enough to return to their homes. Likewise, the financial crisis caused massive economic difficulties in East Asia. As you know, the attack on regional currencies and stock markets is now widely accepted as the main cause of the financial crisis. Once-promising economies of East Asia were gradually weakened to the point where some had to seek international financial aid and impose harsh, but effective, measures like capital and exchange controls.

The attack on regional currencies and stock markets is now widely accepted as the main cause of the Asian financial crisis

The crisis also took its toll on the peoples of East Asia. Millions of citizens of East Asia were made poor and unemployed. Governments were forced to revise their development expenditures, causing the people to be deprived of the benefits of modern developments such as better education, extensive health care and a roof over their heads. As a result of this crisis, the economic divide between the East and West has worsened. Decades of work to build up and strengthen the economies of East Asia went to waste within a period of just a few months.

The economies affected have been forced to take bold and immediate measures to turn their economies around. These measures are not uniform, with many of the affected economies adopting their own pragmatic and practical approaches to expedite economic recovery. For example, Malaysia chose to implement capital and exchange controls to insulate its economy against wild currency fluctuations. These measures are showing positive results, as can be seen in the increase in the country's foreign reserves and trade surplus and a return of business confidence.

The international community has taken note of the dangers of unregulated international currency exchanges, but its efforts to

control these activities have yet to yield concrete results. In the meantime, the contagion effect of the financial crisis is being felt as far afield as the Russian Federation and Latin America. Even the United States, the world's largest economy, and until recently unaffected by the Asian crisis, is experiencing a drop in demand for its products and services, as East Asian economies tighten their belts.

In Malaysia, the economy began to suffer in the third quarter of 1997, forcing the sharp depreciation of the Malaysian ringgit against the US dollar. The Malaysian ringgit, which was trading at M$ 2.50 to US$ 1 on 2 July 1997, sank to a low of M$ 4.88 on 7 January 1998. Efforts to follow the painful and drastic measures prescribed by the IMF did not bring the desired effects to boost the economy. In the first quarter of 1998, the business community and the productive sectors of the economy came under intense pressure as they tried to sustain their operations despite the high fluctuations in the currency exchange rate.

At the international level, the depreciation of one currency set off corresponding depreciations of regional currencies. The currency crisis brought about the collapse of the Malaysian stock market and asset prices. The fall in the exchange rate and in the value of stocks hit businesses hard. Among the first to be hit was the aviation industry, which is extremely vulnerable to changes in the external environment. The impact of the financial crisis on the aviation industry was immediate and not confined to Malaysia Airlines. Indeed, most airlines in the region had to revise their strategies and plans to accommodate the sudden and swift changes in the business environment. The airlines in the Asia-Pacific region took various approaches and measures to face the challenges. All, however, share the same goal, which is to sustain their market share and to strengthen their operations and build up their resources to accommodate future growth in the event of economic recovery.

Prior to the financial crisis, the aviation industry had forecast that 1998 would be another buoyant year, with growth rates expected to exceed 7 per cent annually. Passenger traffic in Asia grew by 7.3 per cent in the first half of 1997, compared with

worldwide growth of 4.5 per cent. However, this growth tapered off to only 1.3 per cent in the second half of 1997, as most airlines in the region experienced a glut in capacity during the traffic downturn in the second half of 1997. The steep depreciation of 40 to 70 per cent in the Asian currencies against the US dollar has made it increasingly difficult to make payments for new aircraft. Consequently, many airlines have cut services, removed surplus aircraft from existing fleets and deferred new aircraft deliveries. There is no quick recovery in sight, and 1998 could well be the worst year for the Asian aviation industry since the 1974 oil crisis.

1998 should have been another buoyant year for the Asian aviation industry, but could well turn out to be its worst since the 1974 oil crisis

In our preparations to overcome the challenges facing Malaysia Airlines, we had to take into consideration several factors. We realized that:

- the financial crisis would have an impact on traffic growth, forcing us to accept more realistic targets for passenger and cargo yields in the short and medium term;
- airline expansion would not be practical financially and operationally considering the excess capacity;
- resources would need to be maximized and costs minimized without affecting the quality of service and operations;
- we would need to stress the significance and importance of strengthening operations and accelerating growth, as the twin strategies to maintain our market share and enhance our revenue base.

Internally, the company undertook several measures to soften the impact of the downturn on the aviation industry. In the past six months, we have made rapid adjustments to remove excess capacity by scaling down our domestic and regional services to destinations affected by the financial crisis. Adjustments have been made by way of partial or complete withdrawal of services to

reduce capacity where seat factors have fallen drastically, and by putting surplus aircraft up for sale or leasing them out and terminating the contracts for leased aircraft when the leases expire.

Whilst we have cut capacity to markets affected by the economic downturn, we are turning our attention to the longer-haul markets in the United States, Europe and Austral.a. We have embarked on a prudent course for recovery in the next few years by scaling down our operations in South-East Asia and North Asia, concentrating on long-haul markets, and moderating capacity-growth projections and fleet requirements for the next few years.

The Malaysian Government's capital and exchange controls, announced in September, are also expected to have a favourable impact on our measures to maximize savings and minimize costs. With the pegging of the ringgit at M$ 3.80 to US$ 1, we expect to make savings in areas like fuel, spare parts, depreciation charges and maintenance. The recommendations of our National Economic Action Council, the special body set up by the

The Malaysian Government's capital and exchange controls are expected to help Malaysia Airlines to make savings in areas like fuel, spare parts, depreciation charges and maintenance

Malaysian Government to support its economic planners in putting forward solutions to expedite economic recovery, will also aid the company's efforts to return to profitability. Eight recommendations have been put forward by the Council, including encouraging suppliers of aviation fuel in Malaysia to charge Malaysia Airlines in ringgit to share the benefits of the price reduction in that commodity.

As we move ahead to chart our future, we have been able to draw certain lessons on how to manage airline growth during the good and the bad times. These are:

- manage capacity increases prudently;
- ensure a good mix of owned and leased aircraft;
- maintain a balance in internal and external financing;

- encourage transactions in trading partners' currency; and
- forge close and strong relationships with valued stakeholders.

Perhaps some of you will be interested to know when the aviation industry can expect to experience an upturn. Unfortunately, there is little to indicate that the industry will soon be enjoying the good times it enjoyed in the past. It is our hope that the economic recovery in Malaysia and in the region will gain momentum with the various measures currently being undertaken by the countries in East Asia and with the move by the G7 to review the current international financial architecture. With the recent news of Japan's decision to commit M$ 114 billion to the region, it is also hoped that the additional funds will help to expedite the economic recovery.

CHAIRMAN

Thank you, Dato' Wan Malek Ibrahim, for your lucid remarks, particularly on the use of capital controls to stabilize the economy. If even a large corporate entity like an airline can be so negatively affected by the crisis, we can imagine how deep the crisis is and what sort of consequences it has for much smaller companies, which are particularly vulnerable to the current credit squeeze and rising costs. Larger corporations have the option of downsizing their operations, but smaller companies are not large enough to downsize. Moreover, it has been reported that even when special funds have been set up by Governments to help small and medium-sized enterprises (SMEs), these enterprises still encounter substantial difficulties in accessing these funds. Bolstering SMEs must therefore be an integral component of any economic recovery plan for the region, considering that they are among the major creators of employment.

Our next two speakers are both heads of Asian SMEs and therefore have experienced the impact of the crisis at first hand. Ms. Dewi Motik Pramono is a Vice-President of the Indonesian Chamber of Commerce and Industry, also known as KADIN. She

is also President of the SME PT Puncak Wawasan Indah, and has devoted much time and energy to promoting the development of small-scale enterprises, especially those run by women. She is therefore particularly well-suited to speak to us today about the impact of the crisis on SMEs in the informal sector and on women.

MS. DEWI MOTIK PRAMONO
Vice-President, Indonesian Chamber of Commerce and Industry

I am very grateful for this opportunity to express my views on the impact of the Asian economic crisis on Indonesian small and medium-sized enterprises in the informal sector and on women entrepreneurs, as I believe that women are the pillar of the country and the future of the nation.

On 30 May 1997, the World Bank released its annual report on Indonesia, which indicated that during the first half of the 1990s the Indonesian economy had been performing very well, with GDP growing at an average annual rate of 8 per cent, and which forecast similar robust growth for 1997. Beware of such compliments! Only two months after the release of this report, the outlook began to look much less rosy as the Indonesian rupiah depreciated steeply in the wake of the depreciation of the Thai baht. By the end of 1997, the depreciation of the rupiah had resulted in a monetary crisis which turned into the most serious economic crisis the country has ever had.

Are SMEs in the informal sector and women entrepreneurs in Indonesia affected negatively by the current crisis? They certainly are. Over the last few months, many newspapers have reported declines in revenue or even bankruptcies of SMEs and small industries in some subsectors. Among those who have gone out of business are many producers of traditional batik in Pekalongan and a hundred small industries producing footwear in clusters such as Jakarta's industrial estate for small industries, known as PIK (Perkampungan Industri Kecil), Cibaduyut, in Bandung, West Java, and Medan, in North Sumatra. Many of those affected have changed profession and become small traders, such as distributors

of basic items – rice, sugar, coconut oil, flour, etc. – transport or construction workers or farmers, since they know that the prices of agro-products such as coffee, pepper, red chilli, cloves, etc. are very high because of the devaluation of the rupiah against the US dollar.

However, despite all this evidence, it would be wrong to claim that small industries and women in business in all subsectors have been negatively affected by the current crisis. Different subsectors or sectors may have different experiences of the crisis, because different industries and individual entrepreneurs producing the same commodity face different internal and external conditions, constraints, challenges and opportunities.

Theoretically, SMEs and women in business, like other businesses, are affected by changes in economic conditions or by environmental shocks which have either a positive or negative effect on the supply side or the demand side. The negative effects on the supply side originate mainly from two sources, the capital market and the inputs market. Interest rates are increased as a result of tight national liquidity and the large companies which provided capital for SMEs before the crisis withdraw their support since they have their own problems to face. The prices of raw materials and other inputs have also increased, some by more than 200 per cent, not just because some of them are imported but also because of distortions in domestic production and distribution. However, the crisis can also have a positive effect on the labour market, in that the increase in unemployment caused by the crisis increases the supply of new workers and entrepreneurs for many small economic activities. In my own country, for example, I have trained jobless people to start their own business with a very simple management set-up.

On the demand side, the stability or continuity of demand is very important for SMEs, as it is for other businesses. There are three major sources of demand for the products of SMEs: the community, business and Governments. The first source represents the final consumer demand in domestic and export markets, while the latter two sources comprise the intermediate demand. If many large domestic companies or government

projects which have business relations in the form of production or demand linkages with SMEs and women entrepreneurs reduce or stop their activities, this may depress demand for SMEs' and women entrepreneurs' products.

The current crisis may also create opportunites for SMEs through production or demand linkages with larger enterprises. In other words, right now there is a large potential for the development of small and medium-sized import substitution industries in Indonesia, since many large domestic enterprises used to import all the capital and intermediate goods they needed, but they are now obliged to turn back to the domestic market for such goods. This can create new demand for the products of domestic SMEs and women entrepreneurs.

Not all SMEs have been negatively affected by the financial crisis – it may actually create opportunites for some of them, for example through demand from larger enterprises seeking to replace imports with cheaper home-produced goods: the depreciation of the rupiah could also mean that their products will be more competitive in export markets

With respect to export opportunities for SMEs, theoretically it is expected that the depreciation of the rupiah against the US dollar will push up Indonesia's exports, including SMEs' products. But so far there is no strong evidence that the country's exports have indeed increased significantly over the last six months, since the crisis began. Many other factors have also played an important role in determining the exports of SMEs, such as their production capacity, the quality of their products, marketing and promotion, and, especially, the quality of their global distribution and the levels of skill and technology they use.

With respect to policy reforms, new strategies should be based on the development of community economies, and the following points should be taken into account:

- The emphasis should be on policy reforms in the trade, fiscal, monetary, industrial and regulatory policy framework rather than on specific programmes for SMEs.
- Programmes favouring SMEs should not be used to compensate for existing policy distortions; rather, the policies causing the distortion should be reformed.
- Welfare programmes, in relation to the IMF reform packages for Indonesia, should be used only in the short term and, where possible, existing SMEs should be used to deliver services and products. It is a positive development that there are no subsidies for cooking oil any more in Indonesia, as it can now become a delivery service product. Welfare programmes should not displace or weaken existing SMEs. Welfare programmes should also incorporate large-scale infrastructure programmes that will have long-term benefits for SMEs.
- Policies and programmes to support SMEs should especially target SMEs in manufacturing subsectors and related areas of services and trade which produce national export commodities which have high comparative advantages – actual as well as potential – such as textiles, garments, leather goods (including shoes), paper products and products made from bamboo, wood and rattan. The policies should also target SMEs producing import substitution goods that have cost advantages in the domestic market.
- The banking sector should be fully regulated in ways that will encourage lending to SMEs and women entrepreneurs.
- A simplified banking law that maintains due diligence should be created for financial institutions specifically set up for lending to SMEs.
- With respect to lending programmes or credit schemes specially designed for SMEs, priority must be given to SMEs working in the subsectors with high comparative advantages mentioned above.

- Tax concessions for SMEs should be improved and banks should be allowed to trade SME loans.
- An independent authority should audit compliance with SME credit.
- If existing banks and other financial institutions already delivering effective credit to SMEs are used for delivery of subsidized credit, there should be a mechanism in place to prevent conflicts of interest and to protect their viability and integrity.
- If subsidized credit is used, it should be strictly temporary and short-term and tied to the market rate at a declining sliding rate.
- An independent agency, other than those concerned with the management of the credit and with no interest in SME institutions, should act as permanent auditors of the scheme.
- In the provision of credit, the emphasis should be on guaranteeing SMEs' suppliers' credit, in a way similar to formal export letters of credit from banks.
- The multitude of existing laws and regulations for SMEs should be eliminated or simplified.
- At the regional and district level, legal and illegal levies and conditions imposed on SMEs should be identified and discouraged, and local officials should be provided with alternative means to raise revenue.
- Systems should be set up, by industry and location, for the careful monitoring and analysis of the changing conditions and market impediments facing SMEs.
- Policies and programmes should be made more specific to sector and location and should take into account the heterogeneous characteristics of the SME sector. The Government should support or encourage the establishment of large alliances either among SMEs or between SMEs and large enterprises, since large alliances can be effective in helping SMEs to face the current crisis.

Reforms should concentrate on getting the regulatory policy framework right, on targeting SMEs which produce import substitution goods, on simplifying the regulations affecting SMEs, and on supporting the creation of SME clusters and alliances among SMEs, as well as alliances between SMEs and larger companies

- Perhaps the most significant aspect of industrial organization of SMEs in Indonesia is the prominence of clusters of SMEs, of which there are many thousands in the country as a whole. While most of these clusters are located in rural areas, many of them are located in urban areas, including in major cities such as Jakarta, Surabaya, Bandung, Semarang and Yogyakarta. So, the development of clusters must be the Government's main strategy for the development of SMEs. Some of the existing clusters producing favourable export commodities or import substitution goods should be selected and developed further with support from the Government. This development strategy can increase efficiency, productivity and flexibility and, hence, the competitiveness of the individual producers in the clusters.
- Experience has proved that agriculture is a pillar of the economy, and has been ever since the colonial era. In order to maintain national economic stability, agriculture must be the backbone of our development. Agricultural development has to be our top priority, and must take advantage of the new agricultural technology. With our richness of natural resources such as tea, coffee, cocoa, etc., and with the right technology, the agribusiness industry will provide one of the solutions to the economic crisis.

- We should use local raw materials for all products and reduce the import component of products for export as well as domestic consumption.

In conclusion, we have no choice but to make SMEs our economic pillar. I really believe that what goes up must come down; with good leaders and with our rich national resources, we can come out of this financial crisis stronger than before.

CHAIRMAN

Thank you very much, Ms. Pramono; you have provided quite a handful of recommendations for UNCTAD to work through and for Governments to follow through, but let me emphasize four of the points you made. First, on the role of the agricultural sector or agribusiness, it is a fact that, because of the financial crisis, the role of the agricultural sector has become more prominent in absorbing unemployment from the urban sector and in providing additional income: so while pursuing the industrialization process, Governments will need to pay more attention to agricultural development than they have done in the past, because in the event of a crisis this becomes a major factor in the adjustment process.

Second, when we carry out financial reform in the wake of a crisis, most of the time we look at the debt-rescheduling of the major corporations. I am not saying that we failed to take note of the liquidity squeeze on SMEs, but it does seem that the problems of the liquidity squeeze as it affects SMEs are much harder to deal with, more numerous and less clear-cut than we thought, and it will take much more time and effort for Governments to deal with them. Although Governments try to channel funds into the banks that will take care of SMEs, it is not clear that the funds are being channelled in the right direction to solve the liquidity crisis of SMEs.

Third, opportunities do arise in spite of the crisis, for example, in the new linkages and alliances between SMEs and larger corporations that Ms. Pramono talked about, and that the Government must help to create.

Fourth, there is the question of domestic price adjustment. There seem to be a lot of price-distorting measures in our economies that prevent us from allowing SMEs to become more competitive. In seeking solutions to the financial crisis, we cannot overlook domestic price distortion, which must also be eliminated.

While pursuing the industrialization process, Governments need to pay more attention to agricultural development, as in the event of a crisis this can be a major factor in the adjustment process: also, they should not overlook domestic price distortion, which can prevent SMEs from becoming more competitive

Our next panellist, Ms. Montigan Lovichit, is the Chief Executive Officer of T. Shinawatra Thai Silk, the oldest silk manufacturer in Thailand, which was founded by her grandfather in 1929. She will describe the impact of the crisis on her company, which has 150 employees, in terms of both the constraints it imposes and the possible opportunities it offers, and how it has affected the company's strategy for the future.

MS. MONTIGAN LOVICHIT
Chief Executive Officer, T. Shinawatra Thai Silk

I have to say that my company is a very, very small company to be talking about during a major crisis, but at least you will hear another point of view. T. Shinawatra Thai Silk is one of the longest-running silk manufacturers in Thailand. Our company was established in 1929 in one of the northern provinces of Thailand, and has been producing handwoven silk fabric since then. In 1960, we opened our factory in Bangkok, introducing power looms into the production line. We have also added automatic dyeing, steaming and pressing machines to improve the quality of our fabric, and can produce new types of silk fabric six times faster

than hand-weavers. Although we have 150 employees and are capable of producing 10,000 yards of silk a month, we consider ourselves a small entrepreneur. Even though we are small, we are proud to be one of the companies producing merchandise that gives Thailand a good name throughout the world.

In the past, Shinawatra was the only place where local people would shop for silk, and busloads of tourists would visit our large showroom every day. However, since 1988, a variety of Thai silk shops have opened up in the Bangkok metropolitan area alone, giving tourists more choice. As our sales were slowly decreasing, we decided to expand our marketing outlets in department stores, duty-free shops and Bangkok airport. In 1993, because of the intense competition, we had to make a strategic and dramatic change in our business plan and invest additional capital in power looms. However, power looms alone only benefited our production capacity. We also had to differentiate ourselves from others, which we did by introducing new eye-catching products. These strategies proved to be successful in the following three years, and our profits rose as a direct result of the 1993 business plan.

Unfortunately, as the saying goes, everything that goes up must come down, and in July 1997 the Thai Government announced the flotation of the Thai baht, which fell from 26 baht per US dollar to 57 baht per US dollar at one time. The price of imported silk yarn from China fluctuated according to the exchange rate, and our costs jumped by 20 per cent. The situation became worse when the financial sector collapsed. Subsequently, demand from local buyers decreased enormously. At the moment we need to invest in new machines – the automatic dyeing machine in our factory is about 30 years old – but since the devaluation of the Thai baht, the price of the machines has automatically gone up, so we are waiting for the situation to improve.

Just as the computer industry needs to resolve the problem of the "millenium bug", so we at Shinawatra need to "vaccinate" our business and prepare ourselves for the year 2000, which we optimistically feel is when the eye of the Asian economic hurricane will whizz past Thailand. As simple as the strategy that we have

put in place at Shinawatra may appear to you, the bottom line in the current economic situation in Thailand is not to make a net profit, but simply to survive as a business.

There are several things we are doing to manage the situation we are facing:

- We are reducing our expenses by cutting down working hours in many sections of the factory; this allows us to avoid laying off workers, which would only create more social problems for the country. The sections affected include the printing, dyeing and finishing departments and some of the machine-woven section. We are also reducing costs by getting new sources of raw material that have the same quality but a lower price. Sometimes we get yarn produced locally, and sometimes we import it. We are constantly looking for lower prices.
- We are introducing new items in order to give customers a greater choice.
- We are placing more emphasis on exports. We stress the importance of quick response and on-time delivery, and we give the customer good service and make sure that the customer believes in our ability to produce the fabric they order. We take small orders and custom-design, so our market is the market for unique and selective products. Other companies may need a certain volume before they can take export orders, but we at Shinawatra take small orders. The devaluation of the Thai baht works for us as a manufacturer by giving us an advantage on export prices in US dollars.
- Right now all our transactions are in cash, because our suppliers no longer give us time to pay. We buy our raw materials in cash, and so we have to sell to our customers in cash also.
- We outsource, and do not turn down customers any more. Before the crisis, we would turn down a customer who wanted a large volume that we could not produce. Thai silk is a hand-woven fabric of which a worker can weave only about seven yards a day, so you can imagine that if

someone ordered 10,000 yards of silk for delivery in one month, we would have to dedicate the whole factory to this customer's order. But now, instead of trying to do everything ourselves, we take partners and get other factories to weave for us, and in this way we can increase our exports.

Shinawatra is managing to survive by making innovations in its products and in the way it works, and by taking advantage of the devaluation of the Thai baht; but it needs new – and expensive – technology if it is to remain competitive in the future

Right now, silk yarn production in Thailand is facing problems because the farmers have stopped producing silk for native yarn. They have changed to growing the Japanese breed because it produces more yarn, but the Thai breed gives the different texture that gives the uniqueness of Thai silk. We therefore put a lot of emphasis on encouraging farmers to keep growing the Thai native yarn. In doing this, we need the help of the new technology to improve production, but getting the new technology is expensive; we need the countries producing this technology – China, France, Germany, Italy, Japan and the Republic of Korea – to help us by lowering their prices.

CHAIRMAN

Thank you, Ms. Lovichit, for your comments. We have now heard from two prominent business women from Asia, and I have to say that in the business sector in Asia "woman power" is one of our secret weapons for tackling the crisis. I would like to tell you a little story about a friend who left his corporation to work in politics and asked his wife to run the corporation on his behalf; it turned out that the corporation was so much more profitable after

he had left that he stayed in politics and his wife stayed in charge of the corporation, much to the satisfaction of both sides. I think this illustrates the importance of the participation of women in all areas of life in Asia and for that matter throughout the whole world.

I think Ms. Lovichit has emphasized two crucial issues. Firstly, SMEs cannot ignore technology. Technology can be a crucial factor in maintaining the feasibility of SMEs, and you need to have the right kind of transfer facilities to transfer technologies from various countries if your SMEs are to survive. And, secondly, it is good news that many SMEs do not lay off their employees as easily as some larger corporations. Like large corporations, they are trying to maximize savings and minimize costs, but they do it in a way that is calculated to have the least possible effect on their employees – for instance, by cutting down on working hours or adopting a rotational way of working. It is really quite an eye-opener that SMEs can maintain their employment levels at a time of many lay-offs in some of the major corporate sectors.

Large and small corporations are all trying to maximize savings and minimize costs, and it is possible to do this without laying off employees – for instance, by cutting down on working hours

Let me now turn to the regional impact of the crisis and its impact on society as a whole. According to a recent World Bank report, what began as a financial crisis has also become a fully fledged social crisis; unemployment has already reached record levels, real wages have plummeted, prices for essential commodities have risen and social services have been cut back. Our next panellist, Mr. Stephen Pursey, Chief Economist of the International Confederation of Free Trade Unions (ICFTU), is well placed to address the social aspects of the crisis, particularly the employment impact, both in Asia and worldwide.

MR. STEPHEN PURSEY
Chief Economist, International Confederation of Free Trade Unions

One of the more startling statistics in the UNDP *Human Development Report* published last month is that the 225 richest people in the world have a combined wealth of over US$ 1 trillion. That is equal to the annual income of the poorest 47 per cent of the world's population, some 2.5 billion people. A world economic system that produces such grotesque inequality is not sustainable, socially, morally or politically.

At Copenhagen, only just over three years ago, more than one hundred Heads of State and Government signed up to a comprehensive anti-poverty, anti-unemployment, anti-social exclusion strategy and programme of action at the United Nations World Summit for Social Development. I fear that when we come to review progress two years from now, we are going to be very disappointed. Mr. Chairman, if I may disagree with you on the observation that you made about SMEs. I am very pleased to hear that Ms. Lovichit's company has managed to find alternatives to laying off workers, but I think the trade union experience generally in Asia is that SMEs have been squeezed hardest, because they are less able to resist the pressures from the larger companies when the liquidity crunch hits.

A world economic system that produces grotesque inequality is not sustainable, socially, morally or politically; the big question is how to make international policies on trade, investment and finance compatible with international strategies to eradicate poverty

Looking at the progress following the social summit that we might be able to measure, Indonesia's version of "20-20 vision" is perhaps revealing: a 20 per cent fall in output, a 20 per cent increase in unemployment, and at least 20 percentage points more

of the population falling back into destitution levels of poverty. It seems to us that the big question before the international community and UNCTAD is therefore how to make international policies on trade, investment and finance at least compatible with, and at best mutually supportive of, international strategies to eradicate poverty.

The ICFTU's regional organization for Asia and the Pacific has led the way in our family of trade unions in developing the policy response to the crisis, and our Asian affiliates have been very active in developing dialogue with Governments, employers and the international financial institutions – with, I have to say, varying success. What I would like to do therefore is to draw on some of their ideas and some of their analysis, which I hope UNCTAD might want to develop. In doing so, I will be basing lot of my remarks on the ICFTU's recent statement to the IMF and World Bank annual meetings, which is entitled "Globalization on trial".

The concluding section of chapter III of the latest *Trade and Development Report* offers a qualified defence of the Asian model and the active role of the State in the development process in a globalized economy. Asian unions, and indeed unions from all over the world, would agree with much of what the *Trade and Development Report* says in that regard. But the hard reality is that Asia does have to reconstruct its model, or models, primarily because the crisis is not just a passing financial shock, but is also generational. The Asia of today was to a great extent built by the first generation to move off the land into cities and into industry. From top to bottom, that generation brought with them a social structure built around extended and interlocking families. The powerful traditions of duty and deference that characterized that generation motivated an era of nation-building and economic development, which managed to do without many of the formal checks and balances of the so-called "mature" industrial democracies. I do not think this was a uniquely Asian experience; many Western countries went through a similar history in shifting from an agricultural peasant society to an urban industrial economy. But the generation that built the Asia of today is now

moving off the scene and is leaving behind a much more complex, well-educated, fragmented society. Without wishing to detract from the value of strong families, the old system simply cannot cope with the pressures of a much more dynamic, fluid and innovative pattern of social and economic relations. Asia will need a more complete set of rules to govern economic and social relations, where the role of the State will be more based on rights, representation, accountability and transparency.

Financial stability is not possible without social stability, and vice versa. That message has, I think, to judge from the latest World Bank report, got across to what is often called the "Washington orthodoxy". But social stability cannot be modelled on a computer. Statistical tools for measuring social inequity and the efficiency of various policy instruments are important but, as well as suffering from an appalling lack of data, they cannot capture people's sense of fairness. To understand and address that issue requires the creation of representative, independent, democratic and free institutions, amongst which trade unions are very important.

Much more attention needs to be focused on building social and financial institutions to regulate markets, built on common international principles

Why are unions important? Because they organize at and around the workplace. Their primary objective is to improve the contract of employment, and that contract is different from all others because it defines directly the relationship between citizens and the now global market. What Asian unions are saying is that to get out of the crisis and prevent future ones, Governments, employers and international institutions need to focus much more attention on building social and financial institutions to regulate markets. Furthermore, so that countries can both compete and cooperate with each other, those institutions need to be built on common international principles.

One of the most important elements of a new Asian model will be social protection. The crisis has exposed the weaknesses of existing State mechanisms and the tremendous strain the crisis has placed on families. The most vulnerable are the young and the old – all the surveys indicate that it is the young and the old who are feeling the effects of the crisis the most – but they are not the only ones affected. When people of working age cannot, for reasons beyond their own control, meet their family responsibilities, basically because they cannot find remunerative work, tremendous damage is done to people's lives and, perhaps more importantly, to their sense of self-esteem. I agree with the *Trade and Development Report, 1998* that the effects of falling school enrolment, increased child labour, falling levels of nutrition, increased crime and substance abuse – all of which are moving up dramatically in the Asian crisis countries – will be felt for many years to come and will be extremely damaging to economic development.

In April this year, in Bangkok, the ILO held a high-level tripartite meeting on the social impact of the crisis – "tripartite" meaning trade unions, employers and Governments. It reached agreement on several elements of what the Asian unions have since called a "social action plan" for the region. These include:

- starting and extending unemployment benefit, pension and health insurance systems;
- improving education and training possibilities, especially for the unemployed;
- improving equality of opportunity in employment – equality of opportunity in terms of agenda, ethnic origin, religion and access to employment;
- a massive increase in labour-intensive public works schemes to compensate for the weakness of current social protection schemes; and
- the development of sound industrial relations systems based on the ILO's core labour standards and on tripartism.

Capital flight and riots on the street are two sides of the same coin: a failure to develop institutions that enable people to articulate their aspirations and fears, reconcile them with the

interests of other groups in society, and develop some consensus on how to move ahead. The trade unions see very clearly that the Republic of Korea was further advanced in this process of institutional development when the crisis hit than Indonesia, and despite all its problems is moving ahead, while Indonesia is having to develop its social and financial institutions in the midst of the fastest, steepest and deepest economic collapse ever seen. Some of the most important institutions in a market economy are free trade unions. In the Republic of Korea they were strong enough to play a part in managing the crisis. In Indonesia they were not, primarily because of decades of military party control and repression.

Looking beyond the crisis, the ICFTU, and its Asian Pacific regional organization in particular, strongly believes that comparative advantage will lie with those countries that have a stronger social cohesion built on investment in education and training, health care and a sound industrial relations system, founded on core labour standards. The most successful countries, we feel, both developed and developing, will be those with institutions that are able to balance and constantly rebalance the market pressures of flexibility and dynamism with the social pressures for security and dignity. The suppleness of a country's institutions will be the key to success. Perhaps we might look forward to the day when the quality of anti-poverty programmes will form part of the indicators used by lenders to evaluate a country's credit rating.

The most successful countries in the future will be those which have strong social cohesion built on investment in education, training and health care, and which also have a sound industrial relations system based on core labour standards

If I may take advantage of the presence of a number of participants from the employers' side of industry, I would like to suggest some ideas that the Asian trade unions have been putting

forward to deal with what they see as a major blockage to recovery, and that is the heavy indebtedness of many companies. As Ms. Lovichit explained, it is the lack of working capital, the pressure to have cash, even to finance export orders, that is causing a major difficulty in companies' restructuring, but underlying that liquidity crunch is often a very narrow equity base and very high gearing ratios of loans to that equity base. The families that own the major companies and, indeed, the smaller and medium-sized enterprises are naturally reluctant to sell shares and lose control, especially when prices are very depressed. This impasse is holding up recovery; indeed it is causing a steady flow of redundancies, shut-downs, wage freezes and shorter working hours, and leaves both national and foreign banks with an overhang of non-performing loans. What the ICFTU is suggesting is perhaps that the International Financial Corporation (IFC) or some other volunteer should be provided with substantial funding to buy shares in Asian companies, take seats on the boards of the companies, and help the companies to develop five- to ten-year financial and social restructuring plans. We would suggest that, in

In response to the heavy indebtedness of many Asian companies, which is blocking their recovery, the International Financial Corporation (IFC), or a similar body, could be provided with funding to buy shares in those companies and help them to develop financial and social restructuring plans

parallel, Governments could start up the social security funds that we and the employers have been recommending, to be supervised by tripartite bodies, not least to protect them from raiding by finance ministers. But these social security funds could, in due course, be capitalized by the IFC's shares, which should be made over as the companies work out their restructuring plans, thus enabling the social security systems to be well founded and also to spread share-ownership and build a wider equity base to industry.

To conclude, there are some indicators that the financial crisis in Asia may have stopped getting worse – in the last few days there have been reports to that effect. Personally, I think it is far too soon to predict recovery. Most importantly for trade unions, the indicators of a social crisis – unemployment, under-employment, poverty – will all continue to get worse for some time to come. Indeed, we cannot expect those sorts of indicators to start to rebound until we get back to 3 to 4 per cent growth per year, at minimum. Indeed, looking at things worldwide, if any country avoids increasing unemployment in 1999, it will be either very well managed or very lucky. World recovery will not be secure until workers' purchasing power in Asia – the epicentre, to use the title of this session, of the crisis – starts to recover.

Mr. Chairman, we feel that financial and social reconstruction must go hand in hand, and that is the input that we would like to make to UNCTAD's work. We very much appreciate the opportunity to give the trade union perspective on these issues and we hope that UNCTAD could further enrich its analysis by integrating a social and employment dimension into its work and in particular into its work on Asia, by building on the ILO's Bangkok Action Programme. The ICFTU very much looks forward to participating in this type of work.

CHAIRMAN

Thank you, Mr. Pursey, and I have to agree with you that in spite of the optimistic mood of the past couple of weeks about the return of financial stability to some of the Asian crisis-hit countries, we have not yet seen the bottom of this crisis as far as its social effects and implications are concerned. The unemployment rate is still rising and social dislocation and the movement of migrant workers continue, and so the necessity to build up social cohesion, which is getting some support from the international community, including the World Bank, is crucial. I found your remarks about the need to enhance the capital strength of some family-owned businesses particularly cogent, and I think that your suggestion to

have the World Bank and the IFC participate in increasing the equity of some SMEs should attract great interest at the international level. I also think that the linkage between economic solutions and social implications is an area in which UNCTAD could do some useful work.

We have not yet seen the bottom of this crisis as far as its social effects and implications are concerned; the unemployment rate is still rising and social dislocation continues

May I now turn to our next panellist, Mr. Hazem El-Beblawi. Mr. El-Beblawi is the Executive Secretary of the United Nations Economic and Social Commission for Western Asia (ESCWA). He will examine the impact of the Asian financial crisis on western Asia, particularly through the drop in petroleum prices and the effects on migrant workers, and explore related policy options.

MR. HAZEM EL-BEBLAWI
Executive Secretary, Economic and Social Commission for Western Asia

What started a year ago as an Asian financial crisis is threatening to degenerate into a global financial collapse and eventually a world economic recession. President Clinton described this crisis as the biggest financial challenge to face the world in half a century. From East Asia to Russia and Latin America, the volatility of financial markets seems to spare no country or region, except those not fully integrated into the world economy. The western Asian region and Africa are perhaps among those least directly affected by the crisis. However, while this is true for direct effects in the short term, the longer-term indirect effects could be damaging to trade and investment flows.

In order to be able to assess the potential impact of the crisis on any region, we should first understand its nature and causes. It

is perhaps revealing as well as disturbing to note that the crisis took everyone, or almost everyone, by surprise. The World Bank and IMF were among those who were caught off guard, and not for the first time. After the Mexican crisis in 1994–1995, it was claimed that the failure of international financial institutions to anticipate the crisis was due to a lack of adequate financial data. A concerted effort to improve the financial reporting system was thus put forward by the IMF, but to little or no avail.

The Asian crisis was yet another surprise. When that crisis first erupted, in July 1997, the immediate reaction was to view the event as a purely Asian phenomenon. Later developments showed, however, that the Asian financial crisis was yet another episode in a long chain of events that point to the volatility of the world financial system and the globalization of the economy. The recent events in Asia no doubt have their Asian features, just as the previous Mexican crisis had its Latin American flavour, but there are also features that are shared by all these financial eruptions, whether in Europe in 1992, Mexico in 1994 or Asia in 1997. Unless we analyse and identify what is basic and common to these eruptions, our ability to cope with future crises will be seriously hampered.

The Asian financial crisis was yet another episode in a long chain of events that point to the volatility inherent in the world financial system and the globalization of the economy

It seems to me that the relations between the financial economy, on the one hand, and the real economy, on the other, have yet to be fully understood and mastered. It is true that the financial economy is not a recent phenomenon; it has, in fact, a long history and is part of our collective memory. We can hardly conceive of any transaction without the intermediation of some kind of financial instrument. Recent developments in finance, however, amount to a quantum change, in which the explosion of financial instruments has blurred the economic scenery.

Conventional wisdom sees in financial instruments mere claims to real assets, which represent the ultimate and true wealth. Financial instruments are thus viewed as no more than derivatives or mirror images of the real economy. This is no longer true. The financial revolution, which brought about phenomenal growth and diversity of financial instruments, also diluted the relationship between the real and the financial. Rather than following the real economy or paralleling it, the growth of financial instruments took the lead, so that they outgrew the real economy. The financial economy has asserted its autonomy from the real economy and forged a life of its own with its own dynamics. Technological progress in information and communications helped promote not only the explosion but also the globalization of financial instruments. Economic policies of deregulation and the liberalization of capital movements sanctioned this trend.

The financial economy differs from the real economy in at least two major respects. Firstly, the financial economy is much less regulated than the real economy. Also, the globalization of the financial economy was not matched by parallel global institutionalization and proper regulation of financial movements. Liberated from national sovereignty, financial movements, more often than not, are extraterritorial movements in no man's land. Moreover, in many cases the domestic financial sector within countries remains fragile and under-regulated.

The financial economy is no longer a mirror image of the real economy, but an autonomous and less regulated symbolic economy; it has become the realm of the herd instinct, speculation and contagion, where psychological shocks are magnified

Secondly, with the advent of the financial economy we are embarking on a symbolic economy in which behaviour is a function of symbols such as the Dow-Jones index, Bundesbank interest rates, and trade and employment figures, as well as

political news or rumours. The financial economy is the realm of the "herd instinct" and hence opens the door for speculation and contagious movements. It is perhaps important to note here the difference in the pattern of capital inflows and that of capital outflows. Capital inflows usually build up gradually over years while capital flights, more often than not, erupt suddenly over weeks or even days. This difference between smooth capital inflows and erratic capital outflows accounts for the inability of the financial authorities to cope with the situation. Also, the increasing role of institutional investors such as money-managers and pension funds tends to magnify rather than offset psychological market shocks.

We cannot complete our understanding of the financial economy without special mention of the role of the international monetary system. Established at Bretton Woods in 1944, it was based on fixed exchange rates, with the dollar as the reserve currency. In the late 1950s, Robert Triffin demonstrated the unstable nature of a system based on a systematic deficit of the US balance of payments to make available the needed international liquidity. Though the fixed-exchange system was abandoned in the mid-1970s in favour of a managed fluctuating system, the basics of the system remain the same, with the dollar as the major reserve currency. The chronic US balance-of-payments deficit is a necessary condition for making available the required international liquidity. In other words, US dissavings is the major source of international liquidity. The system calls for a permanent deficit on the part of the country of the reserve currency. The US balance-of-payments deficit is a basic ingredient of our international monetary system. The paradox of an international requirement on the one hand, and the national management of the dollar on the other, is a serious handicap of the international monetary system. US money management, while assuming an international role, is nonetheless primarily a national affair. Not only is the international monetary system based on the systematic deficit of the country of the reserve currency, but it also stops short of assuring equilibrium of balance of payments among nations. In the "good old days" during the discussions regarding the establishment of a new world monetary

system after the Second World War, it was Keynes' idea to make equilibrium in balance of payments the dual responsibility of both deficit and surplus countries. Deficit countries would be subject to discipline to restore balance in their external relations, but surplus countries would also be subject to some disciplinary measures to help reduce their surpluses, under penalty of having their surpluses written off. The idea was to have built-in incentives to restore equilibrium. Both deficit and surplus countries would cooperate to bring about equilibrium in external relations. Of course, Keynes' ideas were rejected and we were left with an asymmetric system putting all the burden of disequilibrium on the deficit countries while leaving the surplus countries to proceed at will with impunity.

The asymmetric approach to dealing with external disequilibria is taken one step further. Whenever a financial crisis erupts, it is customary to blame debtor countries for reckless and excessive borrowing, as if a debt could be concluded unilaterally. Creditors are usually absolved of any responsibility. In fact, it takes two to lend and borrow, and recklessness on the part of creditors is in many instances no less blameworthy than that of debtors. Policy corrections in the aftermath of a financial crisis are equally important to both debtor and creditor countries. There is a need for a concerted effort and coordinated policies in both creditor and debtor countries. This amounts to a need for a global management of the financial economy to match its global reach, and is perhaps the challenge of the future.

Whenever a financial crisis erupts, it is customary to blame debtor countries for being reckless, but it takes two to lend and borrow, and in many instances creditors are no less blameworthy than debtors

Let me now turn to the ESCWA situation. The ESCWA region's real GDP, excluding Iraq, is estimated to have registered a growth rate of 3.4 per cent in 1997. Although this was below the

5.5 per cent growth rate achieved in 1996, it nevertheless resulted in a positive per capita GDP growth rate for the second consecutive year. Projections show that in 1999 the region's real growth will be only 1.5 per cent, which is below the region's population growth of 2.5 per cent.

Looking at the implications of the financial crisis for the ESCWA region, it has been less affected directly by the crisis than some other regions. Although the adverse impact of the financial crisis on western Asia is not as severe as the sharp decline in oil prices, it is still significant. The adverse implications of the financial crisis in the Far East for the countries of the region stem from its negative impact on the following: the demand for oil; the export of non-oil products by ESCWA member countries; the value of portfolio investments and other assets of member countries; and the risk that all emerging-market countries will be considered as high-risk areas, and thus areas to be shunned by international investors.

With regard to the demand for oil, the financial crisis and its negative repercussions on the economies of countries in South-East Asia have precipitated a decline in the demand for oil from the ESCWA region. For 1997 and 1998, the demand for oil by countries of the Far East was about 400,000 to 500,000 barrels per day, less than had been envisaged prior to the emergence of the financial crisis in July 1997. South-East Asian countries are major importers of oil from the countries of the Gulf Cooperation Council. Thus, the financial crisis caused a decline in economic growth in the Far East, a consequent decline in their demand for oil, and hence a reduction in oil exports by ESCWA member countries.

Also, the financial crisis precipitated a devaluation in some currencies in countries of the Far East by more than 30 per cent. This has made the exports of these countries very competitive on the international markets, and thus reduced the success being sought by some of the ESCWA member countries in increasing their non-oil exports. This is particularly true in the case of exports of textiles, primarily for Egyptian and Syrian exporters.

The financial crisis led to a sharp decline in the value of portfolio investments in the countries of the Far East. Among the ESCWA members, Kuwait is the country with the greatest portfolio investments in South-East Asian countries, and thus it has suffered considerable capital losses owing to the sharp decline in prices on the Asian stock markets. In addition, the sharp devaluation in the currencies of several countries in the Far East has markedly reduced the value of Kuwait's assets in the Far East in dollar terms.

The effect of the crisis on the countries of western Asia has been significant, hitting demand for their oil and non-oil exports and reducing the value of their portfolio investments; the emerging markets in the region also risk being shunned by international investors, who seem to consider them now as high-risk areas

Finally, the financial crisis in South-East Asia and its various adverse effects have shocked international investors. These investors seem now to regard all emerging markets, whether in the Far East or elsewhere, as high-risk countries and thus to be shunned. Several ESCWA member countries, most notably Egypt, are emerging markets with great investment opportunities for international investors. Egypt's current account deficits during the past several years have been relatively low, and Egypt holds more than US$ 20 billion in international reserves, which are sufficient to cover the country's imports for about 15 months. Nevertheless, the bad experience of foreign investors in some countries in the Far East may hamper the flow to countries of the ESCWA region.

CHAIRMAN

Thank you, Mr. El-Beblawi, for your lucid remarks on the effects of uncontrolled financial flows and the effects of the South-East

Asian crisis on western Asian economies. I am sure that the regulation of the fund flows that can determine or destroy the health of any economy in the world with their size and rapidity should be debated further, as should the kind of bandwagon effect that can override the actions of any particular country.

I would like now to turn to our last panellist this morning, Mr. Adrianus Mooy, Executive Secretary of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), which is located in Bangkok, right at the heart of the Asian epicentre of the crisis. Mr. Mooy will describe the broader development impact of the crisis on the region, including countries outside the core such as China, Japan and India.

MR. ADRIANUS MOOY
Executive Secretary, Economic and Social Commission for Asia and the Pacific

I would like to take a broader look at the varied experiences of countries in the Asia-Pacific region in the wake of the crisis, and also to view the developments from a more balanced perspective. At the very outset, it should be conceded that the crisis has turned out to be more severe and more long-lasting than almost anyone had foreseen in the latter part of 1997. I think the negative economic effects, particularly in the hardest-hit countries, are all known to you and therefore I am not going to repeat them, but it has already become evident that there will be a significant slowdown in regional as well as global economic growth during 1998 and 1999, accompanied by a substantial trade slowdown. Volatility and uncertainty in the national financial markets appear to be spreading around the world, enveloping even the financial markets of the developed countries. Investors perceive an increasing risk of corporate and systemic failure emanating from the impaired balanced sheets of the world's multinational companies and banks.

Although these negative factors are highly visible, if we look more closely at the Asia-Pacific region, the overall situation is not

uniformly bleak. Take trade, for instance. In dollar terms, exports from much of Asia have stagnated since mid-1997, but in volume terms the performance of certain countries has been quite encouraging. In Indonesia, the Republic of Korea and Thailand, the volume of exports has risen by 20 to 30 per cent over the past year. Of course, the increase in the volume of exports has only compensated for the decline in the dollar unit prices, but I think this is a good sign, especially if it is supported by declining interest rates and the availability of credits.

Rising export volumes should help to prop up output and employment in the short term. More importantly, by maintaining cash flow, they should help prevent the intensification of corporate and financial sector distress in these countries. Exports should, other things being equal, lay the foundation for a more durable economic recovery from 1999 onwards. Some recovery in exports, combined with sharp cuts in imports, has already brought a significant improvement in two of the worst-affected countries' current account balances. The Republic of Korea, for example, has converted a current account deficit of some US$ 10 billion in the first half of 1997 into a surplus of US$ 22 billion in the same period of 1998. Thailand too has experienced a major turnaround in its external position over the same two periods.

Such dramatic changes in the external positions of these two countries have assisted their Governments in stabilizing their foreign-exchange reserves. Stable foreign-exchange reserves, in turn, have helped in the task of exchange-rate stabilization in the two countries. Both the Thai baht and the Republic of Korea won have appreciated by around 30 to 40 per cent against the dollar since January 1998. This improvement in the exchange rates has allowed a gradual easing of interest rates in the two countries. In the Republic of Korea, three-month rates had dropped from 25 per cent in December 1997 to 11 per cent by the end of August 1998, while in Thailand they dropped from 26 to 14 per cent over the same period. Other countries, notably Malaysia, are experiencing a similar easing of the cost of credit.

These are positive and significant developments by any standards, and augur well for a recovery of output growth in these

countries before too long. Elsewhere in the region, it is striking to note that China and India, two of the largest economies in the region, have not only managed to avoid the sharp exchange-rate depreciations that have characterized the crisis but have largely succeeded in keeping their growth momentum intact. On the basis of present indications, any dip in China's high growth rate is expected to be no more than 0.6 of a percentage point in 1998 as compared to 1997, while in the case of India current estimates suggest a small rise. Indeed, both countries expect to improve on their 1998 GDP growth rates in 1999.

The overall situation in the Asia-Pacific region is not uniformly bleak; rising export volumes should help to prop up output and employment in the short term and should lay the foundation for a durable economic recovery from 1999 onwards, unless the domestic credit crunch in Japan deepens the recession there, which would hold up recovery in the region as a whole

It is noteworthy that both China and India have been relatively immune to the crisis in the rest of the region, in terms of GDP growth. The two economies still have rather low trade-to-GDP ratios, although these have been rising, especially during the 1990s. Moreover, China's integration into the world economy in terms of capital flows consists primarily of foreign direct investment, which provides strictly limited scope for the type of destabilizing financial speculation that has occurred in certain other countries.

As in the case of China, India's large domestic economy and limited exposure to international markets have effectively insulated it from the crisis in the rest of Asia. However, there has been some weakening of the rupee–dollar rate and the stock market has also slid downwards. On the whole, however, weaker regional demand for exports has had only a minimal effect on GDP growth. Likewise, company profits have not been dented much because

exports produce only a small part of total earnings of manufacturing companies. As a result, India's corporate sector has avoided the debt-servicing problems that have beset the countries worst affected by the crisis. Furthermore, access to foreign capital, while diminished, has not ceased altogether. It might be added that India's current economic performance has also been helped by good weather, which has raised agricultural growth by more than 3 per cent during the current fiscal year compared to a decline of 3.7 per cent in the previous year.

In the case of China and India, their large domestic economies and limited exposure to international markets have effectively insulated them from the crisis in the rest of Asia

This brief overview of the region points to two broad conclusions. One, that the region as a whole, especially the two largest economies, namely China and India, continues to perform reasonably well; and, two, even the economies worst affected by the crisis, in particular the Republic of Korea and Thailand, are stabilizing and laying the foundations for the resumption of growth. But these conclusions are subject to a major qualification. My earlier observations on the medium-term prospects of the Republic of Korea and Thailand were predicated on the time-honoured phrase "other things being equal". This qualification needs to be spelt out. Essentially it is to do with what happens to the Japanese economy in the months ahead, and this has a bearing on the region's prospects as a whole. I think here the signs are far less propitious.

The Japanese economy, which was already slowing down before the onset of the crisis, is tending now to slow even further. The Japanese Economic Planning Agency expects the economy to shrink by 1.8 per cent in the current fiscal year. In recent months, exports, business confidence and domestic demand have weakened significantly. Domestic demand, in particular, has serious implications for the region, as in normal conditions Japan is a major importer and source of capital for the region.

This loss of momentum in the Japanese economy has undoubtedly been aggravated by, and has aggravated, the Asian crisis, primarily via its impact on the banking system. In the latter part of 1997 and in early 1998, confidence in the Japanese financial system, already low following the collapse of asset prices at the beginning of the 1990s, was further dented by the bankruptcy and closure of two prominent financial institutions. With further falls in equity values in September 1998, there is a large question mark hanging over the ability of the Japanese financial system to simultaneously maintain an adequate capital base and enlarge its lending to support the real economy. Bluntly stated, there is a real risk of a domestic credit crunch deepening the recession within Japan and, as a result, delaying recovery significantly in the rest of the region. A delayed recovery automatically carries with it serious social consequences for many countries in the region. Of course, the recent announcement by the Japanese Government of a package to assist the financial sector and its promise of US$ 30 billion of aid for the Asian economy give hope for recovery in the region, but it remains to be seen how the package works and how effective it will be.

There can be little doubt that the Asian financial crisis has been a great setback for the social development of the region. After years of exceptional growth, the region was poised to enter the next millenium with confidence and optimism. Incomes were rising rapidly, people's lifestyles and aspirations for a better future appeared well-founded, and absolute poverty was diminishing. An increasing number of women were finding employment in new factories and offices and the participation of women in economic life brought with it additional income for their families, strengthening the family bond. But the crisis has begun to unravel many of these achievements. As the economies of the region have gone into recession, unemployment has been on the rise, and there is growing evidence to suggest that women workers are being laid off at a faster rate than men – the femininization of unemployment is becoming an unfortunate hallmark of the crisis.

While the resumption of growth is a critical and fundamental need, in order to alleviate these emerging social problems in the

short term there is a clear need to protect existing social budgets and expenditures, especially in relation to education, health, nutrition, labour and employment programmes aimed at vulnerable groups, the poor, older persons, disabled persons and ethnic groups. It must not be forgotten that previous high growth rates in several countries were partly a result of sustained investment in human resources. Any sharp cuts in social expenditures will therefore reduce the capacity for recovery and future growth. Given the current resource constraints, better focusing of programmes and more effective targeting of vulnerable groups is of crucial importance. In addition, the impact of social programmes needs to be enhanced. Countries have to produce more results in social development with much less in terms of resources. There is an urgent need to reform social delivery systems to reduce duplication, dissipate administrative or bureaucratic gridlock, and enhance efficiency and economies of scale. There is a clear need to involve also the private sector, civil society and non-governmental organizations in the process.

In order to alleviate the emerging social problems in the short term there is a clear need to protect existing social budgets and expenditures, especially in relation to education, health, nutrition, labour and employment

The Governments of the region are thus faced with daunting challenges. Mitigating the immediate social consequences at a time of austerity is one part of the challenge, but the resumption of sustained economic growth is the main challenge. While there are hopeful signs in the region, serious weaknesses are also evident, both nationally and regionally. Nationally, the financial sectors of many countries are still in a fragile condition, unable to support growth by a significant increase in lending activities. Regionally, the Japanese economy remains weak, unable to provide a boost to countries attempting to expand their exports. The steps needed to support a resumption of growth are also critically dependent upon

a resumption of voluntary private capital flows to the region. However, the return of investors' confidence has so far proved elusive. It is in this fundamental area that concerted efforts need to be directed both nationally and internationally in the coming months. Governments, while taking whatever short-term measures they deem appropriate, need to make a renewed commitment to the principles of openness and liberalization in their trade and payments regimes, although the pace and sequencing of liberalization could of course be adjusted.

Finally, what is of particular concern to the region is a more insidious form of protectionism, namely a proliferation of non-tariff measures by developed countries to protect their markets from products in which the developing countries have acquired a comparative advantage and in which the developing countries have become even more competitive following the drastic exchange-rate depreciations. In the event of a global recession, the use of such

Governments need to make a renewed commitment to the principles of openness and liberalization in their trade and payments regimes, although the pace and sequencing of liberalization could be adjusted

forms of protection could pose a real threat to the region's outward orientation. Given the complexities of the global situation, the strengthening of regional cooperation is imperative if the developing countries are to respond effectively to the challenges ahead and to take advantage of the opportunities.

CHAIRMAN

Thank you very much, Mr. Mooy. I would just like to draw participants' attention to a few of your remarks which could usefully be discussed further. One is your remark on the possible recovery of some of the crisis-ridden countries. I am sure there is

cause for a certain guarded optimism, but I do not think we can say that we are out of the woods as yet. Your remark on the femininization of unemployment is rather alarming. I think this is something that we cannot allow to persist. Unemployment is a major social issue in Asia at the moment, but bias against the participation of women in the workplace would be a particularly undesirable side-effect of the crisis. You mentioned that Asian nations will have to face up to demands for social improvements at a time of financial austerity. This is a situation that needs to be addressed at the international level, since funding arrangements are sometimes biased in favour of economic solutions rather than the provision of a social safety net. You also said that the pace and sequencing of liberalization could be changed: I think we must emphasize the need to devise mechanisms or measures to address this issue and to prevent what we have achieved from being destroyed.

Unemployment is a major social issue in Asia at the moment, but bias against the participation of women in the workplace would be a particularly undesirable side-effect of the crisis

I would like now to open the floor for debate, and give the floor to Ms. Henryka Bochniarz, Senior Adviser to the Deputy Prime Minister and Minister of Finance of Poland, and President of the Polish Business Table.

MS. HENRYKA BOCHNIARZ
Senior Adviser to the Deputy Prime Minister of Poland, and President of the Polish Business Table

Much has been said about the reasons for, and consequences of, the current financial crisis, which is bringing misery to millions of people in different countries and threatening many others. Many proposals have been put forward to manage the crisis or prevent its

recurrence, including the establishment of a new international financial authority to impose greater transparency and to enhance the monitoring of capital flows, but it is obvious that no single diagnosis and no single therapy exist. We are nevertheless encouraged by the solidarity emerging among the member countries of the United Nations family, irrespective of their geographical location and, to an increasing extent, of their social and political systems. In today's increasingly globalized and interdependent economies, nobody can feel immune to what is happening either to their neighbours or to those who live far away from their borders. Nobody can claim exemption from their wider responsibility, and obviously larger and richer countries have greater responsibilities, including for the world economy.

The risk of contagion is imminent if collective, instant and meaningful steps are not taken to prevent the present financial crisis from spreading and to make sure that the lessons from the crisis are fully learned. Early-warning systems must be made more reliable and early warnings must be taken seriously and dealt with accordingly. We support proposals aimed at enhancing surveillance, increasing transparency and improving data collection. We also believe that the IMF should be more actively involved and that organizations such as WTO have an important role to play.

Early-warning systems must be made more reliable and early warnings must be taken seriously and dealt with accordingly

With regard to the private sector, which I represent here, I can guarantee, Mr. Chairman, that the growing number of very successful business women is not just an Asian phenomenon, but can also be observed in Central Europe and in my own country. It is my firm conviction that the private financial sector should be much more actively involved in the management of the present crisis, since public capital alone is clearly inadequate for coping with problems of this magnitude.

I think that the United Nations offers the proper framework within which to seek feasible and generally acceptable solutions. Today's deliberations in this High-level Segment are very timely, and improve the prospects of implementation of the proposals I have just mentioned in a very specific and important way. The attendance of high-level government officials guarantees that what has been said here will be heard in our capitals, both in the South and in the North.

Poland is deeply concerned about what is happening on the financial markets. For the moment, our economy is still intact and we are in a very comfortable position. Our sacrifice during the first period of implementing reforms after 1989 has paid off. We have established very solid fundamentals for sustained economic development. Inflation is under control and is expected to be in single figures by the end of this year – for those of you who do not remember, I would like to remind you that a few years ago we had an inflation rate of over 300 per cent. Unemployment is falling – it is now below 10 per cent – and the budget deficit is within acceptable limits. The currency exchange and the money market continue to attract foreign capital, and not exclusively short-term capital. Since 1989, foreign direct investment has amounted to about US$ 25 billion. The GDP growth rate is above 6 per cent, which is among the highest in the world, and the forecast for next year is above 5 per cent, even after revising it downwards by one point in view of the crisis in the Russian Federation.

Our economic performance has made it possible for Poland to become a full member of OECD. Meanwhile, negotiations with the European Union on Polish membership are under way. About 70 per cent of our exports go to our western European partners and more than 60 per cent of our imports come from them. Our development is therefore based on a stable relationship with the countries of the European Union, which is one of the pillars of the world economy, and we are to some extent protected from the current financial turmoil. The question is, for how long?

While we are proud of the successes and achievements of reforms in Poland, we cannot ignore the highly undesirable and painful side-effects which have accompanied the systemic changes

in our country. Unemployment, drug abuse, organized crime and frustration among young jobless people are relatively new problems for us, and we are only just learning – very rapidly – how to cope with them. We are open therefore to any forms of cooperation with other countries and organizations, and we are ready to share our experiences with and seek advice from others. It is worth mentioning here that the draft framework convention against organized crime, currently under negotiation within the United Nations framework, was a Polish initiative.

I wish to emphasize that the balance of the economic transformation in Poland is clearly positive, and it is in this context that we are concerned about what we might lose if the present financial crisis turns into a global one and strikes our region and my own country. We in Poland are doing everything we can to keep the national economy on the right track of sustained development by observing strict rules of budgetary discipline and macroeconomic policy. At the same time, we are trying not to forget about the social aspects of transition, and in this respect I fully agree with Mr. Pursey's comments.

As the Polish Deputy Prime Minister, Mr. Leszek Balcerowicz, announced at the recent annual meeting of the IMF and the World Bank, Poland has accepted the proposed increase of our quota in the IMF. Replenishment of IMF resources is a matter of urgency if the Fund is to play a role in alleviating the crisis. In this context, I am also pleased to say that my country is ready to support the Heavily Indebted Poor Countries initiative by depositing our share on beneficial terms. I would also like to add that legal procedures have been initiated in Poland to establish official development assistance. To start with, a modest amount will be put at the disposal of countries in need.

Having recent memories and experience of overcoming a very deep economic crisis with quite good results, we are also ready to provide any necessary technical assistance to other countries and their institutions. We would like to contribute constructively to the revival of other economies, and not exclusively those in our region. But as I mentioned before, the larger the country, the greater its responsibility, and I can only call on the other players on the international stage to respond to the challenges accordingly.

CHAIRMAN

Thank you, Ms. Bochniarz, for your emphasis on international cooperation, and it is nice to hear that at least one economy in Eastern Europe has not yet been affected by the crisis, and that Poland is well prepared to meet the challenges.

AMBASSADOR WU JIANMIN (CHINA)

This High-level Segment of the Trade and Development Board has focused its attention on the financial crisis in East Asia. The Chinese delegation believes that this discussion is both timely and useful. We have learned important lessons and gained many insights. I would like to make a few remarks on the questions under discussion.

The financial crisis in East Asia has now lasted for more than a year, and has had a negative impact on the financial and economic situation in many countries or regions, with countries in East Asia suffering the most severe economic losses. The crisis has also had some negative effects on China's economy, mainly on foreign trade and foreign investment. China's exports to Asia have dropped sharply this year: for the first half of 1998 alone, its exports to Asia fell by US$ 5 billion. The devaluation of several Asian currencies, in contrast to the stability of the yuan, has weakened the competitiveness of China's export products. Importers in Europe and the United States have forced China to lower its export prices by about 10 to 20 per cent, which resulted in losses of US$ 6 billion in the first six months of 1998. Whereas in 1997 China's exports increased by 24 per cent as compared with 1996, from January to September 1998 they increased only marginally, by 3.9 per cent. At the same time, foreign investment from East Asia into China has also undergone a sharp decrease of 20 to 30 per cent. We therefore take seriously the negative impact of the financial crisis in East Asia on our economy.

The year 1998 has been a year of daunting challenges for China. Domestically, we have been hit by the worst floods in

history while, abroad, we have been confronted with the financial crisis in East Asia. The Chinese Government reacted to these challenges in a sober and realistic manner by adopting the following policies. Firstly, we adopted a responsible monetary policy: we are determined not to devalue the yuan. In spite of the enormous pressure created by the devaluation of several Asian currencies, China still believes that maintaining the value of the yuan is in the overall interest of both the regional and the global economies, as well as being in China's own interest. The Chinese people have historically always given greater weight to the overall interest, and a "beggar-thy-neighbour" policy is contrary to the Chinese tradition and therefore not a policy option for the Chinese Government. Secondly, China has lowered its interest rates five times since 1996 in order to prevent possible deflation. This year, the Central Bank has provided a capital fund of 270 billion yuan for the commercial banks and subsequently lifted the limitation of lending scale.

Maintaining the value of the yuan is in the overall interest of both the regional and the global economies, as well as being in China's own interest: besides, a "beggar-thy-neighbour" policy would be contrary to the Chinese tradition

Since May 1998, the Chinese Government has issued 190 billion yuan of government bonds and has increased investment in infrastructure projects, including in agriculture and forestry, water conservancy, transportation, communication, renovation of the urban and rural electricity network and environmental protection. Vice-Premier Li Lanqing announced on 1 February this year, at the annual meeting of the World Economic Forum at Davos, that China would be investing as much as US$ 750 billion in infrastructure projects between 1998 and the year 2000. Judging from what we have achieved this vear, we are confident that this target will be reached and even surpassed. China has the highest savings rate in the world: the savings of

Chinese residents amount to 5 trillion yuan, which is the main source of capital. Meanwhile, foreign investments in infrastructure projects are also very welcome.

In order to restructure the export product mix, improve product quality and increase the added value of export products, China is making greater efforts to attract foreign investment by improving its investment environment and has further reformed its foreign trade system. The growth of exports and foreign direct investment has a significant pulling effect on China's economic growth.

Why is it that China has been less affected than other Asian countries by the Asian financial crisis? It is because China is stable both politically and monetarily, its economy is growing and inflation is low. GDP rose by 7 per cent in the first half of this year and is expected to grow by 8 per cent in the year as a whole. Many people have asked me how we manage this. There are several reasons. First, the macroeconomic policy of China is very successful. In the early 1990s, the economy of China overheated and the "economic bubble" phenomenon appeared in some economic sectors. The Chinese Government adopted timely and powerful macroeconomic policies, which reduced the economic growth rate from 14.2 per cent in 1992 to 9.7 per cent in 1996 and the inflation rate from 21.7 per cent in 1994 to 6.1 per cent in 1996. In July 1997, when the Asian financial crisis occurred, the economy of China was in its best-ever shape, which enhanced China's ability to deal with the crisis.

Second, China's economic opening-up is a gradual, step-by-step process. One of our objectives in opening up the financial field is the free exchange of the yuan. To achieve this we have adopted a gradual method, and China has achieved the free exchange of the yuan in the context of current-account projects, though not yet in capital-account projects. Thanks to the guarantees for capital projects, however, international speculators were not able to engage in speculation in China during the financial crisis. At the same time, we also adopted positive and very prudent guidelines on the use of foreign funds. We have chosen to emphasize foreign direct investment, while being

cautious about portfolio investment. China therefore has a rational structure for foreign investment and foreign debt. Foreign direct investment accounts for two-thirds of total capital inflows and foreign debt accounts for only one-third. Medium- and long-term debt accounts for 88 per cent and short-term debt only 12 per cent of total foreign debt arrears, and the debt-servicing ratio is less than 10 per cent. This shows that China was right to adopt a positive and prudent policy when opening up its capital market.

China has been less affected than other Asian countries by the financial crisis because China is stable both politically and monetarily, its economy is growing and inflation is low

I can inform you that financial reform in China will not be slowed down because of the Asian financial crisis. On the contrary, we will be stepping up and deepening the financial reforms and gradually opening up the financial market on the basis of comprehensive financial laws and a comprehensive regulatory system. Recently, China decided to extend the successful experiment in allowing foreign banks to engage in transactions in yuan renminbi from Pudong, Shanghai, to Shenzhen. To stop opening up the financial market would not be in line with the trend towards globalization or in accordance with China's economic development interests. Moreover, the Asian financial crisis has taught us that financial opening-up should not proceed too quickly. Premature liberalization may jeopardize China's national economic interests and may also have adverse effects regional and world economic growth. As the Secretary-General of UNCTAD has rightly pointed out on earlier occasions, premature liberalization is not in the interests of the developing countries.

A third reason why China has remained less affected than other countries by the crisis is that it has a large domestic market. Its economic growth mainly depends on the continuous growth of domestic demand.

The Asian financial crisis has not only a regional but a global impact, and global issues call for global solutions. In order to prevent the crisis from spreading further and getting worse, global cooperation should be strengthened. In particular, the industrialized countries should make more contributions in this regard. Here it is necessary to point out that Japan, as the largest economic entity in Asia and the second-largest in the world, should make greater efforts and contributions to help bring the crisis to an early end and to stabilize economic development in the region. President Clinton has said that the United States is committed to helping the world out of the crisis and getting it back on the track of economic growth. We hope that the United States, Japan and the European Union will adopt measures to stabilize their respective economic and financial situations, strengthen their coordination and make more active efforts to promote the stability and healthy development of the economy and finance in Asia and the rest of the world.

Finally, the research carried out by UNCTAD should be given due consideration and should be fully utilized. I would like to stress that prior to the breakout of the Asian financial crisis, of all the international institutions, UNCTAD was the first to send out warnings – as, indeed, it had been the first to sound the alarm at the time of the Mexican crisis. Regrettably, those warnings went largely unheeded. However, there is a Chinese saying, "It is never too late to save the flock, even after some of the sheep have been lost". Experience has proved that the research work done by UNCTAD is not only of high value but also very valuable in forecasting the economic future. We should consider how to make even fuller use of UNCTAD's research and we should encourage UNCTAD to play an even more important role in financial matters in the future.

CHAIRMAN

Thank you, Ambassador Wu, for emphasizing the need to prevent the kind of "beggar-thy-neighbour" policy that would be of no

benefit to anyone, and for drawing attention to the need for an early warning system, which has been so intensively debated but with, so far, no solution in sight.

I would now like to invite Mr. Vijay S. Makhan, Assistant Secretary-General of the Organization of African Unity, to take the floor.

MR. VIJAY S. MAKHAN
Assistant Secretary-General, Organization of African Unity

The first-hand presentations that we have heard this morning, especially from the private sector in the Asian region, have given us a direct insight into the extremely negative impact of the financial crisis on major companies such as Malaysia Airlines and on SMEs in Indonesia and Thailand. The major theme to emerge from the three presentations made by the representatives of those companies is the need to find local solutions to regional or global problems. We have heard how particular firms in the private sector are finding enterprise-specific solutions and making enterprise-specific adjustments to the crisis. Of course, we have also heard how these adjustments are taking place within the broader context of stabilization provided by the macroeconomic framework.

The dramatic decline of output in the Asian countries has an immediate effect on African countries in terms of the reduced demand for African commodity exports, depressed commodity prices, the virtual termination of investment flows from East Asia, and a possible further reduction in official capital flows as resources are directed towards financial bail-outs in East Asia

The contagion effects of the crisis have not been felt so strongly in Africa since African countries receive negligible capital inflows, both short-term and long-term, but this is not to say that

the ripples spreading out from the Asian epicentre have not reached Africa. In the interdependent world in which we now live, the dramatic decline of output in the Asian countries has an immediate effect on African countries in terms of the reduced demand for African commodity exports, depressed commodity prices, the virtual termination of investment flows from East Asia, and a possible further reduction in official capital flows as resources are directed towards financial bail-outs in East Asia in a bid to avert recession.

The robust growth that we have seen in most African countries during the last few years had already slowed down in 1997, mostly owing to adverse weather conditions. The ripple effects from the Asian epicentre further imply that growth for 1998 and possibly 1999 will be below the robust growth we have seen in most African countries during the last few years. It is against this background that we at the Organization of African Unity/African Economic Community strongly believe that the time has now come for the international community to act decisively on the question of the debt overhang in Africa, to provide breathing space for our Governments and bring in the much-needed assistance in dealing with the social problems our countries face. As Mr. Pursey reminded us earlier, the social dimension of adjustment is always important. For us, it is also very important that this matter should be addressed, as at the end of the day we think that it is people who know what is fair and who suffer the most from such crises.

The seriousness of the debt problem is indicated by the fact that the accumulated arrears on Africa's debt had reached US$ 64 billion by 1996, almost a quarter of the total debt. In the short to medium term, and in the context of the constraints that are now besetting the international financial system, there is simply no other way to support African recovery efforts than to move forward on the debt question and to take the Heavily Indebted Poor Countries initiative forward and, indeed, go beyond it. We must look urgently at this aspect of the problem if we want to avert further deterioration in the situation in our continent.

Finally, I should like to echo the call for global cooperation to stem the spread of the Asian financial crisis. I should also like to call on the industrialized world, and the European Union, the United States and Japan in particular, to contribute further and, in a genuine sense of partnership, to listen to the ideas from the developing world, so that we can try to prevent this catastrophe from hitting the whole world.

CHAIRMAN

As Mr. Makhan said, funds that are being made available to cushion the effects of the financial crisis should not be at the expense of funds intended to help solve the structural problems of Africa.

MR. YOSHIKI MINE (JAPAN)

I would like to limit my comments to a few points of particular importance. First, with regard to the responsibility of the Government of Japan and the efforts it has made, I do not wish to repeat what I have already said at previous meetings, but I would like to say that we are fully aware that we now need to see what the actual results of our efforts will be. I would like to add that our Government is now seriously considering expanding the number of countries eligible for debt relief or grant aid, as well as expanding the types of eligible debt.

Some doubts have been raised, as a result of the Asian crisis, about the desirability of capital account liberalization, and it is right to pay attention to the risks as well as the benefits that such liberalization brings. We believe that capital account liberalization in developing and emerging economies needs to be carried out in the appropriate conditions; for example, a sound financial sector responsible for the fiscal and monetary process and adequate debt levels in the national economy would minimize the risks of abrupt movements of capital. It is also important that the authorities of

the countries concerned fully recognize and control the risks in both the corporate and the financial sector, such as the foreign exchange risks and the risks stemming from a maturity mismatch of external debt. Governments need to formulate and put into effect proper and prudential regulations. Countries should also proceed with the liberalization of direct investment and long-term capital flows before liberalizing short-term capital flows.

Capital controls or a debt standstill may well discourage investor confidence and reduce the efficiency of a national economy because of their arbitrary nature: a forward-looking approach is needed which is aimed at further trade liberalization and at promoting the further integration of the developing countries into the world economy

The emphasis during the discussions at this session on countries, particularly on the developing countries, has provided us with an interesting combination of analysis and prognosis. With regard to the prescriptions such as capital controls and the debt standstill which are included in the *Trade and Development Report*, we are still quite wary about the validity of such proposals, as they may well discourage investor confidence, hamper beneficial capital inflows (including foreign direct investment), and reduce the efficiency of a national economy because of their arbitrary nature. Any proposals to improve the situation created by the financial crisis need to be evaluated in a balanced manner with due attention paid to their feasibility and possible negative impact. I think it is quite legitimate for UNCTAD and the secretariat to be considering the impact of the financial crisis, but I would like to see UNCTAD concentrating more on the analytical aspects rather than discussing the reforms of other institutions that are best handled in other places.

By way of explaining our basic position on the financial crisis, I would like to mention a few words about the Second

Tokyo International Conference on African Development, which has just ended. The primary theme of the Conference was the reduction of poverty and integration into the global economy, and this theme was discussed under the principles of ownership of the developing countries and global partnership. The issues were approached with the emphasis on strengthening coordination – regional cooperation and integration, and South–South cooperation – and through cross-cutting themes such as capacity-building, gender-mainstreaming and environmental management. In other words, the emphasis at the Conference was quite similar to our efforts within UNCTAD, and I hope the agenda for action agreed at the end of the Conference will soon be made available.

Finally, I believe we should be starting now to look ahead to UNCTAD X. We must take a forward-looking approach aimed at further trade liberalization without succumbing to protectionism, while at the same time promoting the further integration of the developing countries and the least developed countries into the world economy.

CHAIRMAN

The Japanese Government's proposal to expand debt relief is good news, and we all look forward to hearing details of the proposal. Mr. Mine's remarks on the proposals contained in the *Trade and Development Report* should also be taken note of, especially as Japan is one of the major exporters of capital in the world.

AMBASSADOR HARALD KREID (AUSTRIA, SPEAKING ON BEHALF OF THE EUROPEAN UNION)

I would like to make some general and, to some extent, programmatic remarks on the topic before us. We appreciate very much the multifaceted contributions of the panel brought together by UNCTAD, and we are particularly pleased that we have been able to hear some first-hand testimonies from the private sector.

The Asian crisis has undoubtedly left its mark on the global scene, and we are now faced with a global reduction in trade which is affecting growth in many countries. This phenomenon is not limited to countries which are lagging behind in their economic adjustment programmes, and which could perhaps therefore be blamed for not doing the right thing. It has also affected some of the countries which had apparently done everything according to the book, and which had been strong performers over extended periods of time, thus giving the impression that their economies were invulnerable, or at least much less vulnerable than others to outside shocks or to regional crises. We cannot therefore consider this crisis as a limited phenomenon that can be coped with by simply concentrating on the economic conditions prevalent in a few countries. We are, of course, aware that it is difficult to define all the implications of this crisis at a time when the crisis is still fully upon us, and a final appraisal will have to wait.

FDI can play an important role in the management of a financial crisis: one of the preconditions for attracting it is openness to cross-border transactions in trade, payments and capital

It is conventional wisdom that sound macroeconomic policies are required to attract foreign direct investment (FDI). Obviously, the openness of markets to FDI can make a difference to Governments' efforts to stabilize their economies, but if you are in a crisis, the basic ingredient of attracting FDI, namely, the confidence of investors, is missing. Thus Governments need to resort to unorthodox measures and explore new avenues of crisis management in a creative way. I would like to thank the panel for giving us some vivid examples of how companies and institutions are grappling with this issue. As this year's *Trade and Development Report* illustrates, FDI can play an important role in the management of a financial crisis and the restoration of a stable investment climate in the medium term. While FDI and other capital flows may not always behave in rational ways and capital

volatility can have damaging effects, it is still safe to state that some preconditions will always be required for attracting FDI. One of these conditions is openness to cross-border transactions in trade, payments and capital. The openness of a country's trade and financial regime gives a signal of long-term reliability and diminishes the risk investors are inevitably taking.

Although at this stage there are no strong indications that we are backsliding into a protectionist phase, we need to be particularly watchful that this does not occur. The European Union is very concerned about protectionist reactions to shifting trade and investment flows, which have already led to significant changes in the relative competitiveness of Asian economies. We believe that protectionism and isolation are not the answer and we are confident that this is well understood by policy makers all around the world. We were recently reassured of this by the representatives of many countries as they renewed their commitment to the liberal multilateral trading system in WTO.

The countries affected by the crisis can only make the necessary financial and structural reforms if they have the ability to supervise and regulate the financial sector, enforce credit discipline and discourage or prevent imprudent lending

As always, to a large extent it is in the hands of the affected countries themselves to make the necessary financial and structural reforms in order to safeguard their economies from future crises of confidence. They can only do this if they have the ability to supervise and regulate the financial sector, enforce credit discipline and discourage or prevent imprudent lending. There is ample room for improvement in these areas, but we cannot hope to arrive at lasting solutions if we proceed merely at the national level. The international community certainly has a role to play, and this role is not limited to the kind of fire-brigade interventions which the IMF has been obliged to carry out in order to prevent the collapse of certain economies.

We believe that the international financial and monetary systems need to be overhauled and adjusted to the new realities which have become apparent in such a dramatic form. In all our efforts, both at the national and international levels, we must never lose sight of the fact that the overriding objective of all of these reforms is to increase the well-being of the weakest and most vulnerable sectors of our populations. This means that our efforts to eradicate poverty must remain at the forefront of our concerns. To achieve this goal – which seems further away today than before – we must continue our efforts to achieve long-term and equitable growth.

CHAIRMAN

UNCTAD has produced a book that deals with the financial crisis in Asia and FDI, which contains a lot of interesting information on FDI, particularly on how regional integration can help to create an atmosphere that is conducive to foreign investment.[1] I share your concern about the threat of reverting to interventionist measures such as tariff and non-tariff measures, and I think such remarks should be echoed at every international forum, not only in WTO.

MR. MANUEL VALENCIA (SPAIN)

This is a crucial time for the world economy and particularly for the developing countries, and I would like to commend UNCTAD on its far-sightedness and independence in foreseeing two years ago the possibility of a financial crisis beginning in the economies of East Asia. I would like therefore to express support for the continued role of UNCTAD as a forum for reflection and consensus on measures to be adopted to prevent economic crises,

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[1] UNCTAD, *The Financial Crisis in Asia and Foreign Direct Investment: An Assessment*, Geneva, 1998 (United Nations publication, sales no. GV.E.98.0.29).

and also as an institution for encouraging trade and development in the developing countries, particularly in the countries with structurally weak economies and in the least developed countries. I would also like to express my satisfaction at the organization by UNCTAD of the Partners for Development meeting to be held shortly in Lyon and at the possibility that a Biotrade office might be opened in Seville soon. The objective of the Lyon meeting, that is, collaboration between trade and development bodies and the private sector, seems a realistic objective.

With regard to the international financial crisis, Spain does not attribute exclusive responsibility either to the developed countries, where speculation generally originates, or to deficient legislation, possible corruption, or speculation sanctioned by Governments or by domestic laws in other countries. We believe that there is a shared responsibility on both sides and in each country the circumstances and causes are different, as has been shown in studies by the specialized international financial bodies. Furthermore, economics is not an exact science, and attempts to control economic parameters at the regional and national levels have once again failed.

In the past 15 years, reactions to the various financial crises have been very different in different countries. The Latin American countries in the past 10 years have made profound structural changes in their economies which have allowed them to reach high levels of stability and growth, and this has meant that they have been able to face the financial crisis that originated in Asia in much better shape than other developing countries. It would seem unfair if this crisis also affected those countries that have done their economic homework properly.

We need to examine very carefully in all the international economic forums – the World Bank, the IMF, the OECD, UNCTAD, WTO, etc. – the measures we could take to prevent future crises of this kind. I would like to suggest the following: some limitation of the international volatility of financial flows; maintenance of the process of liberalization of international trade; and support for the developing countries to help them to improve their legislation in this field, to increase transparency so as to avoid

corruption insofar as possible, and to adjust their economic, budgetary and credit structures to more realistic levels. There should also be more economic analysis and follow-up by the IMF in certain countries and the World Bank's capacity to provide financial assistance to countries in a critical situation should be increased.

Spain supports these measures, as announced by the Prime Minister at the Ibero-American Summit in Porto and the Deputy Prime Minister and Minister of Economic Affairs and Finance at the World Bank and IMF meetings in Washington a few weeks ago. Our country is in favour of setting up a special fund to assist countries in crisis and since we practise what we preach, we have offered some US$ 5 billion under the Hong Kong agreements signed last year to contribute to the reserves of the IMF, particularly for East Asia. Furthermore, if the international financial situation requires urgent action to be taken, Spain will contribute a further US$ 3 billion to the IMF to help to stabilize the

A special fund should be set up under the auspices of the IMF to assist countries in crisis, and the World Bank's capacity to provide financial assistance to countries in a critical situation should be increased

Latin American economies, which are especially important to Spain because of our historic and increasingly close economic ties with them. We are trying in this way to avoid financial contagion, particularly in Latin America, where, after the crisis of the last decade, welcome structural changes have been made that have left the countries of the region in a better position to deal with this kind of crisis.

As agreed at the Porto Summit, both the developing countries and the countries affected by the crisis are responsible for finding a solution. We will have to take measures, as has already been done in certain Western countries such as the United States, Spain and the other countries of the European Union, to ensure that the

world economy does not slip into recession. A recession, which is a real possibility, would affect the people of countries at all stages of development, particularly developing countries and the least developed countries.

CHAIRMAN

I think we all agree that if we are to overcome this crisis, the contagion needs to be stopped from spreading, especially to Latin America, and so the efforts by the IMF and countries like Spain to mobilize adequate funds for this purpose deserve the support of everyone concerned.

MR. MICHAEL ARIETTI (UNITED STATES OF AMERICA)

Let me first compliment the speakers on their excellent presentations, which have given us a wealth of insights into the causes and effects of the financial crisis in Asia. It is especially useful to hear the graphic descriptions of the effects of the crisis on individual companies and workers and on the general population. It is quite clear that the social impact of this crisis is something that needs much more attention from the world community.

I should underline that these issues are extremely important to the United States. We used to call it the Asian financial crisis, but it is now widely recognized that we are dealing with a global financial crisis, a market problem that is as serious as any we have faced since the Second World War. In the United States, our own financial markets are now being seriously affected; even the most respected American companies are finding it more costly to raise funds on equity or debt markets, major financial institutions are revising profit forecasts and downsizing payrolls, banks are tightening capital standards, short-term financing is in vogue and, of course, the stock market has declined significantly.

I would submit that what we have heard this morning corresponds in many respects with the analysis of the United States

Treasury Department. The current difficulties have their roots in a long period of excessive borrowing by financial institutions and companies, combined with severe institutional and, in some cases, political problems such as inadequate financial supervision and regulation at the national level. Of course, it would be wrong to put all the blame on the borrowers. For every borrower, there is a lender, and our lenders clearly have been guilty of "irrational exuberance", to quote Mr. Alan Greenspan.

The current difficulties have their roots in a long period of excessive borrowing by financial institutions and companies, combined with inadequate financial supervision and regulation at the national level: and the impact of these mistakes is greatly magnified by the unprecedented speed and force of new information technologies and financial instruments

Today, the impact of our mistakes is greatly magnified by the unprecedented speed and force of new information technologies and financial instruments. When we see withdrawals of capital of more than 10 per cent of GDP in some cases, it is hard to believe that the general flight from risk has not been exaggerated by the technological means at our disposal.

My Government is committed to restoring growth and confidence to the troubled economies and to helping to prevent further contagion in international markets. The core elements of a strategy for containing the immediate crisis are becoming broadly accepted, particularly after a series of meetings earlier this month. I would submit that this strategy rests on three pillars. First, we need strengthened policies in the major industrialized economies – that is to say, the United States, the European Union and Japan – which are aimed at providing an environment conducive to growth. Second, we need effective and sound macroeconomic policies in the countries most affected – policies aimed at the fastest possible return to growth, political stability and

comprehensive corporate and financial restructuring where necessary. And third, we need continued international support, primarily from the IMF, to give countries a "bridge" to overcome temporary liquidity problems.

Also, over the longer term, we need to promote additional steps. I believe there is now becoming clear a broad consensus on three other important areas for reform. These were highlighted in concrete proposals put forward earlier this month by experts from the key industrialized and emerging nations. First, we need increased transparency and disclosure by companies and by financial institutions; generally accepted accounting principles must be respected at the corporate, national and international levels. Second, we need strengthened financial systems, including new standards and principles for corporate governance, bank restructuring, risk management, etc. And, finally, we need more effective burden-sharing arrangements in response to financial difficulties, particularly at the domestic level, so as to prevent company failures from becoming national crises, and national crises from becoming international crises.

An environment conducive to growth, sound macroeconomic policies, international support to help countries to overcome temporary liquidity problems, increased transparency and disclosure by companies and financial institutions, strengthened financial systems, and more effective burden-sharing arrangements in response to financial difficulties – these are the pillars of a strategy to avoid financial crises

In these brief remarks I am in a no sense attempting to provide all the answers to the problems we face, or even to suggest that all the answers are known, but, in our view, following through on the fundamental concepts and ideas I have identified will set us on the path out of the crisis that we have been facing.

CHAIRMAN

I think we should not be looking for institutions or people to blame for the crisis, but should be concentrating on finding solutions, and now that most of the major economies of the world are aware of the potential threat of a worldwide recession, we are in a very good position to avoid such a recession.

AMBASSADOR MOUNIR ZAHRAN (EGYPT)

I have listened with interest to all the points of view presented so far at this meeting. As all parts of the world have been represented in these comprehensive discussions on the crisis and its economic, financial, trade, investment and developmental aspects, there is no doubt that these discussions will be extremely useful in helping us to identify the causes of the crisis, find a remedy and avoid future crises.

Among the lessons to be learned from the crisis is the fact that it was preceded by the cancellation of the rules governing the financial sector and the liberalization of the movement of capital, and therefore warnings about the dangers of over-rapid liberalization were quite justified. The evidence shows that some of the economies in Asia which had financial controls in place suffered less from the crisis; we have listened with particular interest to the comments made by Mr. El-Beblawi, Mr. Mooy and the Ambassador of China on this subject. However, it would be inaccurate to attribute responsibility for the crisis to local policies alone; all parties have to share the blame for this crisis. We have also noted the recommendations made by the Group of 24 at its meetings in Caracas and Washington on the need for lenders and borrowers from the government sector to shoulder their share of the burden. The experience of the financial crisis in Asia has proved that the cancellation of controls and guarantees in the field of external borrowing and the lack of supervision by the Government of private investment can constitute a dangerous source of instability.

Another lesson to be learned is that the assistance coordinated by the IMF during the financial crisis in many cases came too late, that is, after currencies had already been devalued. In many cases, this assistance created other problems, in that it protected lenders from the consequences of their policies and placed the burden on the shoulders of the borrowers alone.

The evidence shows that some of the economies in Asia which had financial controls in place suffered less from the crisis; however, sound fundamentals were not sufficient to guarantee immunity from the crisis

Although many countries have carried out policies aimed at reforming financial assistance during the last few years, these policies unfortunately did not provide total immunity to the financial crisis or afford protection from its side-effects. In other words, sound fundamentals were not sufficient to guarantee immunity from the crisis. We have seen that some economies had a sound economic basis but were still exposed to shocks because multinational companies were present in more than one market, and some of them were obliged to sell their portfolio investment in the markets of strong economies in order to obtain the liquidity necessary to enable them to face their losses in other financial markets. We should not lose sight of this fact.

There is a need to warn against the trend towards protectionism. We have noticed that there is a tendency in some developed countries to impose protectionist restrictions and to impose restrictive measures on exports from some of the countries whose financial markets have been exposed to the crisis, on the pretext that they are taking these measures within the framework of anti-dumping measures. They are restricting access to their markets for products from countries whose currencies have depreciated, and whose exports can thus benefit from lower prices. We have to warn against such restrictions because it will lead to a proliferation of protectionist measures. We have to take into

account the fact that, from the perspective of developing countries, the ability of a country to import is linked to its ability to export, and there are therefore dangers inherent in these measures and in this protectionist trend in the different parts of the world.

I listened with great interest to what Mr. Pursey had to say about the need to take into account the social dimension, and would like to pay tribute to the policy pursued by the World Bank to provide loans to some countries in East Asia to help them to face up to the social impact of the financial crisis. The crisis is not confined to the social and economic spheres but might also have political repercussions that could affect the political and economic stability of some countries. This dimension needs to be taken into acount in UNCTAD's future analysis.

In conclusion, I would like to congratulate UNCTAD warmly for the excellent analysis in its latest *Trade and Development Report;* we hope to receive more analysis of this quality in the future.

CHAIRMAN

Thank you for your warning against the danger of backsliding into protectionism, which is a danger I think we cannot overemphasize.

MR. LEE
International Labour Organization

I would essentially like to comment on the lessons for social policy which we should draw from the Asian financial crisis, which I think are relevant not only to the crisis-affected countries but indeed to all developing countries which are rapidly integrating into the global economy. Firstly, I think it is important to remind ourselves of how severe the social impact of the crisis has been. Large falls in growth rates have, not surprisingly, had a very swift and very severe impact on the labour market. For example, in the Republic of Korea, one in twenty workers lost their jobs in the first

nine months of the crisis, while in Indonesia our estimate is that one in five of the workers in the modern sector have lost their jobs since the crisis began. In addition, as various speakers have mentioned, real wages have also declined.

In these circumstances, however, those who were in need benefited very little from existing systems of social protection. Only the Republic of Korea had some form of unemployment insurance in place; generally speaking, there were no social assistance programmes for those in need, the capacity to step up active measures such as emergency job creation was relatively weak, and traditional support mechanisms, such as returning to the countryside or seeking employment in the informal sector, were overwhelmed by the magnitude of the crisis.

As a result of the severity of the unemployment shock and the weakness of existing social protection, there has invariably been a substantial rise in poverty in the worst affected countries, with an additional 10 to 20 per cent of the population falling through the inadequate safety nets and ending up in poverty. Quite clearly, I think the ultimate solution to this grave social problem is to do the maximum both internationally and nationally to achieve quick economic recovery. In the meantime, of course, the maximum should be done in terms of increasing social expenditures to try to increase the proportion of those in need who can receive social support during this period of crisis.

I think we should draw lessons from this situation. One important lesson is the importance of strengthening systems of social protection. I think it is clear that when we talk about economic crisis and the increased vulnerability of all developing countries across the world, this whole issue of what can be done to strengthen social protection should be very high on the policy agenda. Specifically, I think that serious consideration should be given to the introduction of unemployment insurance, given how serious the employment impact has been, and I think that, contrary to popular misconceptions, well-designed unemployment insurance schemes are feasible and affordable. Our feasibility studies show that such schemes can be financed for less than 1 per cent of payroll costs. It could be a self-financing system and if it was

carefully designed it would have only very minor negative economic effects in terms of distortions or incentives. So there are compelling reasons for introducing unemployment insurance and, given all the weaknesses which we have seen in the social safety net, its introduction needs to be treated as a matter of urgent priority.

Serious consideration should be given to the introduction of unemployment insurance, given how serious the employment impact of the crisis has been; a well-designed unemployment insurance scheme is feasible and affordable and would have minimum negative economic effects in terms of distortions or incentives

I think the crisis has also shown the importance of strengthening social institutions, especially those in the labour market. Strong social partnerships, based on the full respect of basic workers' rights and freedom of association, between unions and employers' organizations leave a country better equipped to deal with periods of serious economic and social crisis. There would be enormous benefits in terms of negotiating equitable packages, distributing the burden fairly and mobilizing the sort of social support which is essential for sustainable recovery. There would also be benefits, of course, at the enterprise level, where there is a lot that can be done if you have a strong system of industrial relations.

CHAIRMAN

I would now like to invite our panellists to make their last remarks before we adjourn this morning meeting.

DATO' WAN MALEK IBRAHIM

As we are all aware, the Asian financial crisis has become an international catastrophe, but the problem now is the speed with which we are reacting to this crisis. I have heard a lot of talk about solutions, but have yet to see the crisis really being tackled on a practical level. From the point of view of the business sector, we need immediate action to prevent the further escalation of the crisis. I would like to see some forum or task force really do something about the crisis now, because of the serious consequences it has for ordinary people, especially the workers and employees who are the first to be affected. I would like to appeal to everyone here to take some initiative, whether it be at the individual, company or country level, to overcome the problems.

MS. DEWI PRAMONO

I agree that it is very important to take action now. I am happy to mention that Switzerland stepped in immediately with help for our SMEs and jobless people. Under a programme set up by the Swiss, Indonesian SMEs prepared the land for green beans and the Swiss gave us technical know-how and some money and bought all the green beans. I will soon be talking with the Italian Government, which is also prepared to help the small enterprises in my country, especially in the area of agribusiness tools. What we really need now is action, not just programmes.

MS. MONTIGAN LOVICHIT

I would just like to make a comment on labour in Thailand. In the past, people migrated from their home town to Bangkok to get a job, but now the unemployment rate in Bangkok is very high, and so they have to move back to their home town. If they could get access to the new technology to help them raise more silk yarn, they would be able to earn their living in their home town, and would not need to migrate to Bangkok any more. This would also help users of raw material, such as my company, to get more yarn.

MR. STEPHEN PURSEY

I should like to echo those who have supported the *Trade and Development Report*'s analysis and proposals on the reform of international financial institutions. I think we share many of the ideas that are contained in the *Report*, but we would argue very strongly that reform must be buttressed by a social pillar. Companies have to handle financial reconstruction side by side with employment and social reconstruction, and Governments and international institutions need to look at it in that perspective as well.

The ICFTU would certainly agree very strongly that protectionism should be avoided – it is not a solution and it would only make matters worse – but we are getting a bit fed up with trade experts making speeches that simply assume the benefits of liberalization are self-evident. When trade patterns shift, it is very often the low-skilled and low-paid workers who find it hardest to adjust, as well as those who have very specific skills and perhaps live in areas where there are few employment opportunities for the skills they have. So what trade unions are constantly trying to do is to work with management to adjust to new realities while avoiding massive and sudden job losses. You cannot do that when prices shift by 50 per cent in a matter of weeks. Economic rationality goes out of the window when you have that sort of volatility. It is also very hard for workers in richer countries to accept massive and sudden trade changes when it is clearly not the workers in other countries who are the main beneficiaries, because these workers are not properly represented. That is why the ICFTU believes very strongly that these sorts of issues need to be addressed in the next trade round, primarily to build some meaningful defences against the threat of protectionism. A policy of making speeches about how bad protectionism is, is not good enough: we need something tangible, a useable tool.

MR. HAZEM EL-BEBLAWI

This crisis teaches us that we need to be humble and modest, and admit that the social phenomenon we are facing is very complex. All of us, particularly the international financial institutions such as the World Bank, have a long way to go before we understand everything that is going on.

MR. ADRIANUS MOOY

When I said earlier that there were signs of hope, I did not mean to paint a very optimistic picture, but certainly we need to learn from our past mistakes and I think one of the mistakes we made in East Asia was overconfidence. On the other hand, I think it is the responsibility of all parties – the developing countries, the developed countries, Governments, the private sector, international financial institutions and non-governmental organizations – to build on the basis of whatever positive signs there are. There has been a lot of talk about the causes and policy prescriptions, but what we need now is real action.

Part II

The ripple effect and lessons to be learned from the crisis

In the afternoon session of the High-level Segment, a live video link was established with the Second Committee of the General Assembly in New York.

MR. RUBENS RICUPERO
Secretary-General of UNCTAD

I would like first of all to welcome all our friends and colleagues in New York, particularly Ambassador Asadi, Chairman of the Second Committee of the General Assembly, and Mr. Nitin Desai, Under-Secretary-General for Economic and Social Affairs. This is the second time that we have established a direct video link with the Second Committee of the General Assembly in New York – we always try to remind the missions that although we are separated by the North Atlantic, UNCTAD is an integral part of the United Nations and a subsidiary body of the General Assembly, so it is for us always an opportunity of particular satisfaction when we can work directly with the Second Committee or other bodies located in New York. Recently, we had an extraordinarily positive experience, when, together with the World Trade Organization, we helped in the preparations for the discussions of the Economic and Social Council on trade, which resulted for the first time in unanimous agreement on concrete recommendations.

For the benefit of our colleagues in New York I should like to point out that what we are trying to do today is not to repeat what has already been said about the causes of the crisis in Asia or the more generic aspects of that crisis, but to add value to the debate, and we hope to do this in two ways in particular. One is to bring in representatives of the private sector from the affected

countries to hear from them how they are coping with the challenges of the crisis, and the other is to introduce a regional perspective by inviting the five regional economic commissions of the United Nations to participate and share with us their analysis of the impact of the crisis on their regions. I would also like to stress that we are trying to convey a proactive message that crises should not be accepted passively or fatalistically, but should be faced with determination. This is the basic intent of this meeting: to be action-oriented and to propose concrete ideas. Some of the ideas proposed this morning were very pragmatic indeed – sometimes they may not seem to be particularly grandiose because they are limited to particular areas of trade or investment – but even though they may be modest, they are useful, and we hope that Governments and institutions will take good note of them.

AMBASSADOR BAGHER ASADI, ISLAMIC REPUBLIC OF IRAN [New York]
Chairman of the Second Committee of the General Assembly

As Mr. Ricupero pointed out, this is the second joint meeting of the Second Committee of the General Assembly and the UNCTAD Trade and Development Board. I am particularly happy that the process which started last year at the fifty-second session of the General Assembly has continued this year. Our joint meeting today, which we are able to hold thanks to the fruits of the age of communication, provides all of us on both sides of the Atlantic with an opportunity to make a valuable and timely contribution to the ongoing international dialogue that is attempting to determine the causes of the ongoing financial turbulence and crisis and to devise appropriate responses.

The Second Committee has been seized with the matter since it began its substantive work earlier this month and our discussions today, I am sure, will make a valuable contribution to our work during the remainder of the session. While the twin processes of globalization and liberalization are, for better or for worse, facts of life – and there seems to be universal agreement on this particular

point – there is less agreement on what to do about them and how to do it. That is the main challenge we all face, and it is clear now that no country is safe from the ripple effect of the current crisis even when its fundamentals are sound, let alone otherwise. There is much talk about various aspects of the problem, but one thing is clear, and that is that no remedy is yet within our grasp and, even if it were, no single remedy could cure all. In choosing ways to resolve the financial crisis, we must first try to understand what is happening, and this understanding is in itself to a certain degree elusive. During the past few weeks, we have heard here in New York in the Second Committee assessments of the crisis from the perspective of member States, including those who have been directly affected. Today we have an opportunity to revisit the issue from the point of view of the world of business and finance, and also from the perspective of the regional commissions of the United Nations, as Mr. Ricupero underlined. At this point, I have the pleasure of giving the floor to Mr. Nitin Desai, Under-Secretary-General for Economic and Social Affairs.

MR. NITIN DESAI [New York]
Under-Secretary-General for Economic and Social Affairs

May I welcome our partners from Geneva, H.E. Mr. Panitchpakdi, who is chairing the High-level Segment, Mr. Ricupero, our colleagues from the regional commissions and of course our distinguished panellists from the world of finance and industry. We are now linked across the Atlantic, and if the stories are to be believed the last quarter of this millennium has been characterized by the emergence of what has been described as the "Atlantic community", which has shaped much of the world economy as we know it. Of course, the community that we represent here and in Geneva spans not just the Atlantic but all the other oceans too. And that is perhaps the distinct feature of the value that this meeting is going to add to the current dialogue on how to manage this crisis. Let me stress it is not just a financial crisis, it is an economic and developmental crisis which has seized the world

economy over the past year or so. What we represent here, in the sense of the global community of nations, is a set of concerns which go far beyond issues of financial stability to deal with issues of development. What we want is not just adjustment, but development, and I think this is the dimension which United Nations forums like the Second Committee and the Trade and Development Board are best able to inject into the dialogue and discussion. We look forward to the injection into this dialogue of perspectives from business and industry, the financial sector and the regional commissions.

For the benefit of participants in New York, and any in Geneva who had not attended the morning meeting, the Chairman gave a brief summary of the morning's discussion.

CHAIRMAN'S SUMMARY OF THE MORNING'S DISCUSSION

The purpose of the High-level Segment is to add value to the current debate on financial crisis and, more specifically, to suggest how to respond to the crisis and how to prevent future crises from occurring. To my mind, this morning's session contributed admirably to this objective by providing insights from the actors directly involved, that is, from representatives of small, medium-sized and large enterprises, who told us how they have been coping with the effects of crisis, from representatives of the United Nations regional commissions, who told us how their respective regions have been responding, and from a representative of the International Confederation of Free Trade Unions, who described how the crisis has impinged upon the social sector. Each of the speakers provided us with valuable lessons on how to respond to the current crisis and prevent future crises, and put forward practical suggestions for policy makers as well as for decision makers from the private sector.

While not minimizing the impact of the crisis on the enterprise sector, especially on small and medium-sized firms, the three representatives of business this morning provided us with a

rich account of their diverse experiences in dealing with the crisis and implementing the necessary measures to survive while laying the basis for future performance once recovery is in sight. The crisis affected both large and small enterprises through its sudden and severe consequences on demand as well as on supply conditions. In the airline industry, for example, judging from the experience of Malaysia Airlines, the impact on business was immediate; growth in passenger travel decreased dramatically between the first and second half of 1997, leading to a glut in capacity. Simultaneously, the steep depreciation in the value of Asian currencies increased costs, leading to the worst situation in this respect since the 1974 financial crisis. The responses were manifold: flights to regional destinations suffering from decreased demand due to the crisis were scaled down, attention was shifted to long-haul destinations with stronger demand, capacity was adjusted by eliminating surplus aircraft through the sale or non-renewal of leases, and, perhaps most importantly, steps were taken to minimize costs and maximize efficiency. The lessons for large enterprises in this type of industry are that they must manage capacity prudently, ensure a good mix of internal and external assets, and establish strong links with shareholders.

When it comes to SMEs, the financial crisis has hit this particular sector rather hard through lower domestic demand brought about by falling production, reduced government expenditures and rising unemployment. Also, inflation kept on rising at the beginning of the crisis as a result of higher import prices and costs. Increases in transport distribution costs have also added to the cost of production, while the credit crunch and the steep increases in the costs of debt-servicing and new credit have all added to the severe problems that SMEs have to face. SMEs that try to maintain investment in machinery and equipment need to remain competitive by improving their own efficiency in order to qualify for bank loans. Nevertheless, SMEs have been quite successful in maintaining their levels of employment despite the reduced demand through their efforts to change working hours and to encourage rotation among workers.

In spite of all this hardship, there are opportunities during this crisis. SMEs using mostly local inputs tend to have a stronger competitive advantage in export markets. In addition, there is a bigger domestic market for substitute products as imports become too costly. Equally worth noting is the increased importance placed on inter-firm partnering and outsourcing, on new and improved technologies, and on better services and supply flexibility to enhance quality and efficiency, to increase product range and to better respond to market opportunities, including by shifting to activities less affected by the crisis, most importantly in agriculture. This morning, it was also emphasized that SMEs' access to finance and other support could be made much easier and could be enhanced through the reform and streamlining of policies and regulations. In this context, the possibility of the World Bank and IFC participating in strengthening the capital base of some SMEs was noted.

While some SMEs have managed to stay afloat, others have adapted by changing to activities where demand is robust enough to be sustained despite the crisis, but many have indeed gone under. This highlights the question of how to deal with the social consequences of the Asian crisis and future crises and, specifically, how to minimize their impact on the poorer sections of society. The answers for Asia could be closely related to the recognition that the crisis in Asia is not simply a sudden shock but has a "generational" element, albeit to varying degrees in different countries. As Asian economies become more complex and globalized, they must establish more complete sets of rules to govern economic and social relations and must build institutions to implement them. The crisis has also exposed the weaknesses of existing institutions to protect the weaker elements of society, and a social action plan such as the one proposed at the ILO tripartite meeting in Bangkok in April 1998, emphasizing core labour standards, could play an important role in establishing the basis for improving the framework for social stability. Coupling social reconstruction with financial reform could, indeed, be a valuable strategy for long-term growth.

This morning's session also yielded a comprehensive picture of the overall regional situation as regards the crisis, its effects and responses. Against the background of the new global financial economy, which is much less regulated than the real economy, and the resulting policy problems to which that asymmetry gives rise, a succinct picture was provided on the effects of the crisis on western Asia, outside the epicentre itself. These effects have been largely indirect, through reduced import demand for oil from East and South-East Asia, reduced import demand for selected manufactures, and reduced inflows of portfolio and other capital investment to the region due to contagion as regards risk perception.

A broader picture of the situation in South, East and South-East Asia was also provided in the form of a clear account of the diversity of experiences in the region. That picture provided grounds for guarded optimism, with growth in the two largest countries, China and India, only very modestly affected by the crisis, and some of the affected countries already showing some signs of recovery. On the other hand, it is clear that the region is not out of the woods yet, not least because of the questions related to the Japanese economy, with its strong links to developing countries in the region. The account of Asian experiences also alerted us to the need to devote attention to certain areas that may not as yet have received the attention they deserve. These include, for example, the need to take steps to avoid the femininization of unemployment in the crisis-affected countries, the need to recognize the financial costs of social reform, and the need to protect against a backward slide in policies, particularly into protectionist policies, while considering the appropriate pace and sequencing of financial liberalization.

I would like now to turn to our distinguished panellists. Latin America was once thought to be immune to serious contagion from the Asian crisis, but it is Latin America's economic woes that are making headlines these days. Our first panellist this afternoon, Mr. José Antonio Ocampo, Executive Secretary of the United Nations Economic Commission for Latin America and the

Caribbean (ECLAC), will discuss how his organization's assessment of the impact of the crisis on this region has evolved and what policy lessons can be drawn from it.

MR. JOSÉ ANTONIO OCAMPO
Executive Secretary, Economic Commission for Latin America and the Caribbean

Let me start by making some comments on how we see the economic situation of Latin America evolving as a consequence of this growing financial crisis. When talking about Latin America, of course, we have to start by emphasizing that the region has been highly praised in recent years for the structural reforms going on throughout the region, which include many of the features considered to be signs of good economic performance, that is, fiscal strength (though with some exceptions), domestic financial strength (a result of the hard lessons learned by Latin America through many domestic financial crises starting in the early 1980s), and also a fairly low, at least by Latin American standards, current account deficit (although deficits increased as a result of the return to rapid growth in 1997).

The effects of the East Asian crisis have been transmitted through both trade and financial channels. In the trade area, I should emphasize that the major effect has been the reduction in commodity prices. The other effects, that is, the direct effect of lower demand from Asia and the competition from Asian producers in third markets or in Latin American markets, has been of lesser importance. Commodity prices, as this year's excellent *Trade and Development Report* has pointed out, are very significant for some countries. Venezuela, for instance, has received a shock equivalent to close to 6 per cent of GDP as a result of the reduction in oil prices. Other countries, including Chile and Jamaica, have received shocks equivalent to 2 to 3 per cent of GDP as a result of the reduction in metal prices. I should also mention that all countries have benefited from lower prices for

imports, particularly of manufacturing goods and, in oil-importing countries, of oil, but the net effect for the region has been negative.

In the financial area, there were clearly two stages in the crisis. The first was the October 1997 shock, which coincided with the second shock in Asia. This shock was very substantial for Brazil but was less severe in the rest of the region. In this first phase we saw some movements in exchange on the capital markets in January–February and May 1998, but generally none of those movements was of a substantial nature. However, in the second stage, in August and September 1998, the financial shock was substantial and generalized in Latin America and the Caribbean. The shock has been reflected both in the interruption of the most volatile capital flows to the region and a substantial increase in the spreads on US treasury bonds, with the result that the effective interest rates on Latin American bonds in secondary markets now fluctuate between 15 and 25 per cent in dollars, which is of course a prohibitive interest rate and eliminates the use of this sort of financing altogether.

A characteristic throughout the whole period has been the rapid response of the authorities. I must emphasize that in no period in the economic history of Latin America has there been such a rapid response by the authorities to maintain confidence in their economies. For this reason, I must say – and I think there is a general agreement by analysts in this regard – that the effects of both the lower commodity prices and the financial repercussions exceed anything that could be expected on the basis of domestic fundamentals. I might add that this is also true of Asian countries. In Latin America in particular, there has been a substantial slowdown this year from a growth rate of over 5 per cent in 1997 and in the first quarter of 1998. Our estimate for 1998, which was recently revised, is 2.6 per cent, and we are estimating that Latin America will only grow by 1 per cent in the last quarter of 1998 as compared to the last quarter of 1997. So there has actually been a substantial slowdown going on throughout the year.

What have we learned? Let me briefly respond to that question in five ways. First, like my colleague from ESCWA this morning, I think we have learned that we have to be humble and

admit that nobody quite knows how to predict economic crises, or even how to manage them. Our inability to predict a crisis, the herd behaviour of investors and the overkill of some programmes are clear signs that we know much less about the crisis than we need to if we are to manage the macroeconomy successfully.

In Latin America, the effects of lower commodity prices and of the substantial and generalized financial shock in August and September 1998 exceed anything that could be expected on the basis of domestic fundamentals

Second, we have learned that there are systemic risks in the way the international financial system is working. In particular, there is an enormous discrepancy between the sophistication and dynamics of the financial world and the institutions which regulate it. In other words, we do not have adequate institutions for financial globalization.

Third, we have learned that there is an urgent need for short-term action to avoid the crisis from spreading at an even faster rate. According to the conclusions of the recent meeting of the Heads of State and Government of the Iberian and Latin American countries, there are two sorts of policies which are urgently needed. The first are expansionary policies by industrialized countries, as has been increasingly accepted by the US authorities and also by some European countries and the Japanese authorities. At the moment, it is very clear that Japan has decided that both fiscal stimulus and financial reforms are required, but some fiscal impetus may be required even outside Japan. The other policies needed in the short term relate to the provision of funds on a more regular basis than the ad hoc funds raised for the Mexican crisis in 1994–1995 and for the Asian crisis in 1997. That is why the Heads of State of the Ibero-American countries asked for permanent funds to be available, and I think we should praise in particular the very rapid response by the Spanish authorities, which was mentioned this morning by the representative of Spain.

Fourth, due to the fact that the financial crisis has shown that there are some systemic risks, there is an urgent need for an overhaul of the international financial architecture. This means building on the current international cooperation in this area to bring it to a higher level, and that will require a significant set of changes in several areas, including macro-coordination, increased surveillance by the IMF, increased information and transparency (as has been emphasized by that institution), better financial regulation and supervision, and the development of orderly debt work-outs, which should involve the private sector. As the *Trade and Development Report* makes clear (and I must emphasize the quality of the analysis in part I, chapter IV, of this year's report), we also need tighter controls on short-term flows, both at source and in the receiving countries, and some regional mechanisms to support stabilization programmes. ECLAC agrees with the *Report* that this is no time to think about the further liberalization of capital markets, and that we need really strong institutions for financial globalization in this area before we proceed to any further liberalization.

There is an enormous discrepancy between the sophistication and dynamics of the financial world and the institutions which regulate it: the international financial architecture is in need of an urgent overhaul, including increased surveillance by the IMF, better financial regulation and supervision, the development of orderly debt work-outs, and tighter controls on short-term flows

The fifth lesson that we have learned is that we also have to strengthen our domestic macroeconomic management and, in particular, that we have to build stronger buffers during boom periods in order to be more resilient when we have to face the crises which inevitably come up at some point in the history of any country. This implies building stronger fiscal and domestic

financial institutions, and exchange regimes which are properly combined with the active management of external liabilities.

CHAIRMAN

Thank you, Mr. Ocampo. I take note of your emphasis on the need for a new international financial architecture, a call that has now been echoed throughout the world. It is to be hoped that all the parties and international organizations concerned will take part in the process of drawing up this new international financial architecture, so that it will not only bring about greater international financial discipline but will also link this discipline to development and the enhancement of trade flows.

I would like now to go on to our next distinguished panellist, Mr. André R. van Heemstra. Contrary to the initial expectations of some commentators, the Asian financial crisis has spread beyond East Asia and affected the operations of companies with operations in a number of countries. Unilever is an Anglo-Dutch business with a turnover in 1997 of US$ 50 billion. It consists of over 500 companies, has manufacturing facilities in 90 countries and sells in an additional 70 countries. Mr. André R. van Heemstra is President of the East Asia Pacific Group of Unilever. He will share with us how Unilever, with its worldwide presence, has responded to the financial crisis.

MR. ANDRÉ R. VAN HEEMSTRA
President, East Asia Pacific Group, Unilever

My starting point is the effect of the financial turmoil on our most important constituent: our consumer. In countries such as Indonesia and Thailand, an average-income housewife has seen a dramatic decrease in the value of the shopping basket she can afford. Allow me to introduce to this meeting Mrs. Bunyati Muhammad (by the way, Bunyati knows that I will be talking about her at this meeting). Bunyati is thirty-three years old, a

typical middle-class housewife living in Jakarta and a mother of four. Her family's disposable income is roughly half of what it was a year ago owing to the cut in her husband's salary. Her husband, an office clerk, was making 600,000 rupiahs a month and now is down to Rp 300,000. At the same time the prices of most daily goods have gone up by 50 to 100 per cent. She spends just over Rp 10,000 – just over one dollar per day – on food and daily needs. This excludes the rice which her husband receives from his employer. She can no longer buy chicken or red meat, and now the family occasionally eats fish or eggs. She has stopped her normal habit of going to the supermarket to stock up, and instead buys smaller pack-sizes and bottles of her favourite brands at the local "warung" or at the corner store. Bunyati has given up saving altogether.

To this downturn, we see individual consumers respond with ingenuity. It was of crucial importance for us to follow this closely, and to adapt rapidly to changing consumer behaviour with corresponding creativity. My objective today is to highlight a number of examples of our actions, and then to reflect in more general terms on the role multinational companies can play in helping societies cope with economic adversity.

The discussion of this crisis therefore begins at the micro level. It begins with the breadwinner in Thailand who has lost his Bangkok job and returned to his rural home, the large extended family in Manila, and housewife Bunyati in Jakarta. Their crisis is our crisis. To us it presents itself primarily as a consumer issue, and we have no illusions as to the severity of the impact being felt throughout millions of households in the region. The crisis is felt through retrenchment and wage cuts. Since 1996, jobless rates have jumped from less than 3 per cent to over 6 per cent in Malaysia, from roughly 2 per cent to 9 per cent in Thailand, and from just over 4 per cent in 1996 in Indonesia to well over 15 per cent today. The crisis is also felt through inflation. The fact that in some cases consumers face prices which have more than doubled serves to illustrate the depth of the predicament. The combined effect of income loss and price inflation has sent the real

spending power of households plummeting in countries such as Indonesia and Thailand.

This then also becomes a crisis of consumer confidence. Recent research conducted for Unilever indicates that a substantial majority of Malaysians and an overwhelming majority of Indonesians see their current economies as much worse than they were three months ago. The survey also shows that only a quarter of Indonesians and Malaysians see a better prospect in the next three months. Yet despite this pessimism, we see incredible resilience among the people of these nations. In various Asian markets, in the wake of painful economic turmoil, we are seeing a resurgent individual determination to survive. Unilever has noticed it in, amongst other things, the sudden boom in the number of tiny retail shops and one-person kiosks selling anything from soap to automotive oil.

To Unilever, the crisis presents itself primarily as a consumer issue, and the plummeting spending power of households as a crisis of consumer confidence

Individuals have responded with creativity and innovation. Corporations must do the same. Unilever's contribution to dealing with the crisis has remained consistent with our overall business mission to fulfil everyday needs of people everywhere, however we can. We have attempted to respond with creativity and innovation in adapting our product range and its underlying supply chain. For example, in Manila we have seen an almost 40 per cent increase over our 1996 count in the number of stores which sell our product categories. We have taken special measures to ensure a similar increase in the stores we call on. In Indonesia, Unilever is increasing its coverage from 275,000 to 350,000 outlets. This takes us deep into the countryside, stimulating enterprise, into places where outlets can be reached only by a single dirt track. The rise in retail outlets has dictated that we use new and, in many cases, elegantly simple alternatives to perform the "capillary" form

of distribution necessary to get to them. They include the small rural delivery van and the three-wheel bicycle. We now even arrange foot patrols with suitcases on wheels in tow to reach the smallest of hidden-away shops.

As for our product range, we have added to our present assortment new branded products of more modest composition with significantly lower selling prices. In some instances we were able to reformulate existing brands with more cost-effective ingredients without affecting performance. For example, in the toothpaste category, where consumers continue to demand effective cleaning and cavity prevention, Unilever has developed a new chalk-based technology which allows us to deliver these benefits equally well at much lower cost. Then we have introduced new smaller product sizes to make existing brands more affordable to consumers. We have also developed new approaches to packaging in order to reduce costs without sacrificing the performance of the product in use. In some markets we have introduced new refill packaging as a more economical way to offer household cleaning products. In others, we have supplied margarine in large boxes from which the product is scooped in-store.

Unilever has responded to the crisis by adapting its supply chain to reach more, often small and remote, outlets, and by introducing cheaper products of more modest composition, smaller product sizes to make existing brands more affordable, and more economical refill packaging for some household products

These types of initiatives follow lessons which we have learned over the years and across the globe, where we operate in 90 countries. We evolve on the basis of the knowledge and experience Unilever managers have built up when confronted with similar challenges at other times and in other places. For example, our experience in dealing with the consumer impact of economic

turbulence in Brazil and Hungary some years ago has proved very pertinent in South-East Asia. Rapidly transferring best practice to countries where it is needed is a distinct strength of a truly "multi-local" multinational. And we do, indeed, consider ourselves a multi-local multinational. This is a leading factor in the symbiotic growth relationship we have with the countries in which we operate. We find it important to integrate in local societies and to share their concerns. At the heart of our activities lies the transfer of new skills and technologies combined with energetic marketing. In doing this, we bring about more room for competition – precisely the opposite of what is often believed to be the impact of multinationals.

In addition, our operations create ample opportunity for new business partnerships. This can be as suppliers of raw and packaging materials; as suppliers of services, particularly distribution services; or as manufacturers of products which, for a variety of reasons, we prefer to have made by a third party. For example, in that hardest-hit country, Indonesia, where we have operated since 1933, we work together with a multitude of SMEs who are our business partners. In numbers this equates as follows: for every person employed directly by Unilever Indonesia, there are six who are working for us in a dedicated partnership, and that has continued throughout this crisis. This even excludes our 100 small to medium-sized suppliers of raw and packaging materials, many of whom started up business supplying to us, and larger third-party manufacturers who do not produce solely for us.

Our contribution in Indonesia supports the thesis that even in times of economic crisis neither small nor large enterprises can claim superiority, as there may exist such strong and mutually supportive interdependence between the two. And it is in this spirit of interdependence that all parties, from large multinational corporations to small local entrepreneurs, must work in cooperation to eliminate inefficiencies and waste in the normal commercial process, particularly in times when there is no growth to fuel productivity improvements.

Thus today in Asia, more than ever, corporations must reassess the management of their internal and external business

processes. In Malaysia, at the beginning of this year, Unilever launched a comprehensive drive to eliminate inefficiencies from our operations, and to achieve the same results with less waste of materials and resources. This is not simply a cost-cutting exercise. It is the elimination of unnecessary activities and material losses that do not contribute to the creation of consumer value. Since the first quarter of 1998, when the programme was introduced, we have delivered annualized savings of close to US$ 2 million, or double the target we set ourselves. This allows us to mitigate inflationary price increases.

More than ever in this market environment, businesses have also recognized the critical importance of improved cash management principles to survival in these difficult conditions. Beginning with the multinationals, and slowly cascading down through the supply chain, there has been a concerted approach to strengthen commercial controls, tighten credit controls, reduce capital expenditures and cut inventories. It is our responsibility, indeed, it is our corporate mandate, to transfer and share best practice with all our interdependent business associates.

Internationally operating businesses have a unique contribution to make to the debate in which often the definition of "national interest" so easily becomes prominent. International businesses have the first-hand experience to articulate the potential for win–win outcomes of increased international activity and local partnership.

When there is no growth to fuel productivity improvements, it is particularly important for large multinational corporations and small local entrepreneurs to work together to eliminate inefficiencies and waste, and to improve their cash management

In summary, we at Unilever continue to welcome active participation in any dialogue, forum, think-tank, organization or institution committed to eliminating barriers to trade and

eliminating inefficiencies while promoting the free exchange of goods and ideas. We remain committed to this dialogue, especially in East Asia, where Unilever has a long history and a strong belief in its future. This commitment is evident from the energy with which our operating companies in various countries are tackling the present problems and turning them into new opportunities. And this can only be accomplished by looking at markets in the long term, and at the same time ensuring that we remain focused on individual consumers' needs. In responding to these, we must remain committed to the spirit of creativity that fosters innovation.

Bunyati's family will grow up. Perhaps her daughter may hope to train as a hairdresser. Her elder son may go to university and become an engineer. They will remember the impact the economy has had on their family. They will be determined to help shape a better future. Unilever is committed to be there to meet their needs.

CHAIRMAN

As we have been accustomed to hearing only criticism of multinationals, it is refreshing for a change to hear from a multinational that is making an effort to be socially accountable by making adjustments so that it can reach into the poorer segment of the population affected by the crisis and by making adjustments in the way it packages its products so that the cost can be reduced. I hope that this refreshing experience of social accountability by a large business will be taken as an example to be followed by other multinationals.

I would like now to turn to our next distinguished panellist, Mr. Ali Abdel Gadir Ali. The African continent is also beginning to be affected by the spreading economic crisis, although not as dramatically as Latin America. Mr. Ali Abdel Gadir Ali is Director of the Economic and Social Policy Division of the United Nations Economic Commission for Africa (ECA). He will examine the impact of the crisis on Africa, particularly through the effect of falling commodity prices on poverty levels and on

sustainable development. He might also wish to share with us ECA's views on an appropriate response to the problem.

MR. ALI ABDEL GADIR ALI
Director, Economic and Social Policy Division, Economic Commission for Africa

At the risk of sounding redundant, let me begin by recalling that this panel is supposed to explore the ripple effect and related systemic effects and the policy lessons that can be learned, and to consider what Governments and international organizations can do both to prevent crises from recurring and to relaunch investment, trade and development after the crisis. As panellists, we are expected to examine the impact of the crisis on our respective regions and to explore alternative policy responses open to Governments and international organizations. The relevant part of that brief for Africa, I will be arguing, is what Governments and international organizations can do to relaunch investment, trade and development on a sustained basis and within a decent time horizon.

To support this argument, Mr. Chairman, let me start by pointing out that in studies of the Asian financial crisis, there are typically very few references to Africa, and when it is mentioned it is often as a sort of appendage to Latin America. Without getting involved in the other possible reasons for this treatment, I would submit that it could be taken as a sign of the marginalization of the continent in issues relating to the Asian financial crisis. Indeed such a conclusion will not be far from the truth. Africa's marginalization in the world is an established empirical fact. All you have to do is to refer for example to the 1998 United Nations *World Economic and Social Survey*, where you can see that Africa's share in 1997 world exports of US$ 5.5 trillion dollars was only 2.2 per cent and that its exports to Asia, excluding Japan, amounted to only US$ 11 billion, amounting to 9 per cent of Africa's total exports and to 0.2 per cent of world exports. Let me give some further indicators of Africa's marginalization:

- ninety-one per cent of African exports were primary commodities and only 0.7 per cent were manufactured goods in 1996;
- according to UNCTAD's *World Investment Report, 1998*, flows of foreign direct investment to developing countries in 1996 amounted to nearly US$ 130 billion: Africa attracted only US$ 5 billion of that;
- according to the World Bank's *Global Development Finance*, portfolio equity flows to all developing countries amounted to US$ 46 billion in 1996: equity flows to Africa were zero up to 1990, peaked at US$ 4.9 billion in 1994 and declined to US$ 2 billion in 1996;
- according to UNCTAD's *Least Developed Countries Report 1998*, 33 of the 48 least developed countries in the world are African countries.

These are only some of the indicators of the marginalization of the continent, and I am sure everybody around this hall would have their own indicators for that marginalization. So the continent is marginal in the global economy and hence, to the extent that the Asian financial crisis will impact on the continent, it will impact on the continent as an external shock – and the continent is famous for being extremely vulnerable to external shocks.

In what follows, recalling our mandate as panellists, I will offer a few comments on three major issues: trade marginalization, debt and the financing of development in Africa.

The argument as far as we are concerned is very simple. Africa is the continent which has failed to effect an effective developmental process, in the sense of the transformation of production structures from reliance on primary production to secondary production. In the absence of such a transformation, economic management prescriptions are likely to produce only marginal effects, if any, on the trade of the continent, especially export growth. Sadly, however, since independence most African countries have failed to effect such a transformation. Thus, the challenge for the continent remains one of development. In this

light, the supply constraints of lack of capital, technology, human resources and infrastructure are structural development constraints that are hardly amenable to short-term policy manipulation. This, we feel, is a fundamental issue on which we need to agree.

The current challenge of effecting development in the continent has become increasingly complicated by globalization. For one thing, there does not seem to exist a viable development strategy that African countries can pursue as of now. The old import substitution industrialization strategy which graduated the East Asian "miracle economies" which are now in financial crisis is no longer available. Flows of official development assistance, previously used to finance development projects, relax the various supply constraints and eventually effect the transformation, are in decline and are expected to fall further in the future. And private capital flows, which have increased at phenomenal rates recently, are not flowing into Africa as a region, once again because of its failure to effect the transformation in the first place. We are facing the possibility of a new vicious circle of poverty, and this time it is an African circle of poverty.

To relaunch investment, trade and development after the crisis, it is necessary to address Africa's marginalization in world trade and its debt problems, and to find ways to finance Africa's development, but the political will to cancel Africa's debt is lacking, and international targets for the reduction of poverty in Africa are often unrealistic

Africa, of course, appreciates the various schemes that have been devised in the world trading system to increase its access to markets and hence to increase its share in world trade with the ultimate objective of reversing the decline of its share in such trade. In our view, however, it is the failure to effect development that explains why Africa is marginalized in world trade, and continues to lose ground despite the existence of the Generalized System of Preferences, which has now been operating for

over 30 years. Moreover, it is in the context of this type of understanding that we should be able to appreciate why the utilization rates of the Generalized System of Preferences tend to be lower in the least developed countries than in non-least developed countries, and why they tend to be higher in non-African countries.

From this type of analysis, it should be clear that we are arguing that access to markets is a basic competitiveness issue. Competitiveness, in turn, is defined by the stage of development and the sophistication of production structures. The issue of deepening the preferential treatment under the Generalized System of Preferences begs the fundamental questions facing the continent. Indeed, at one level of analysis, the advocacy of increased preferential treatment is inconsistent with the analytical framework informing policy-making at the national level, where Governments are increasingly asked to abandon programmes designed to help the poor and vulnerable in society. Why is it relevant for advanced countries to have systems in place to help poor countries to access various markets?

The policy content of recent research on the importance of geography in explaining the growth performance of different countries identifies regional economic integration and cooperation as a viable direction to take for integration in the global economy. In the long run, we believe that the African Economic Community will be viable, but viability will depend on the development of countries at the national levels. Thus we end up with the importance of breaking the African vicious circle in a globalized world. This, I trust you will agree, is a very demanding challenge.

Now I would like to move on to debt issues. While Africa is appreciative of the various initiatives in this respect, including the Heavily Indebted Poor Countries initiative, and the recent attempts to broaden them, we wish to note that in the past the political dimension of Africa's debt seems to have been de-emphasized. With the now invigorated civil societies in the continent, issues of debt are increasingly being discussed in that dimension. An example of this political articulation of debt issues by civil society organizations is the recent meeting organized by the Mozambican

Debt Group, in collaboration with the African Debt and Development Network and the European Debt and Development Network, held in Maputo from 31 August to 2 September 1998. At that meeting, Ms. Graça Machel, the President of the Foundation for Community Development, noted that we needed to accept that the debt crisis was a shared responsibility, that creditors, indebted Governments and civic associations all had to live up to their responsibilities, and that creditors needed to realize that their contribution to that was the cancellation of the debt. The meeting felt that donors did not have the political will to cancel Africa's debt, since where that will had existed in the past they had cancelled debt or bailed out countries and creditors.

Similarly, Mozambique's President Chissano has recently dealt with the debt issue in its political dimension, though he stopped short of calling for the formation of a debtor cartel. In a speech in Kingston, Jamaica, on 20 September 1998, he argued that developing countries should fight together on the issue of foreign debt and seek not a reduction, but the total scrapping of their debt. The significance of this comes from the fact that Mozambique is considered an example of "best practice" under the Heavily Indebted Poor Countries initiative.

I will move on now to the final axis of this commentary on financing African development. Despite variations in reported results about the exact incidence, depth and severity of poverty of Africa, headcount ratio estimates vary for the 1990s, but generally agree that between 40 per cent and 50 per cent of the population of Africa fell below an international poverty line of one dollar per day in 1995. There is general agreement that poverty in sub-Saharan Africa, as distinct from North Africa, some 40 years after independence, continues to be widespread, deep and severe. It is no wonder, therefore, that most of Africa's development partners have generally agreed that the overarching objective of development is the eradication of poverty in the long run and the reduction of poverty in the short and medium runs. Various international forums have articulated this agreement in quantitative objectives with respect to a number of socio-economic indicators highly correlated with poverty and deprivation. One such

articulation requires the reduction of current poverty levels by half by the year 2015. This will require poverty to decline at an annual rate of 4 per cent per annum.

Taking into account possible changes in the distribution of income during this relatively long period of time, and using relevant poverty lines that change with income over time, it can be shown that to achieve the poverty reduction objective of international conferences such as UNCTAD, mean per capita income in sub-Saharan Africa needs to grow by an average of 5.8 per cent per annum on a continuous basis. Assuming that the population continues to grow at 2.8 per cent per annum, this means that sub-Saharan Africa's GDP will need to grow by about 9 per cent per annum to reduce poverty by half by the year 2015. African GDP growth of 4.5 per cent is considered in a number of quarters as a sign of economic recovery, and yet the required rate of growth for GDP to reduce poverty by half in 17 years' time is 9 per cent: I suggest that this kind of growth rate is almost an impossibility. Moreover, the financing of this type of required rate of growth of per capita income or GDP does not augur well for the working of the international financial system. As I mentioned earlier, foreign direct investment is not flowing into Africa, official development assistance is in decline and there seems to be nowhere that Africa can go to finance this type of requirement.

So let me then conclude, Mr. Chairman, that we need to confirm that a realistic African perspective would subscribe to the general drift of the forthcoming report of the United Nations Secretary-General entitled "Global financial flows and their impact on the developing countries: Policy-making in a world of volatile finance". According to the draft of the report: "Policy advice that was guided by the Washington consensus was unable to stem the decline or protect distant countries from contagion. The developing countries that had once been considered the most successful and worthy of emulation were brought down low." The report admits that in its search for a New York consensus it does not seek a "complete departure from the Washington consensus, but rather a pragmatic modification of it in the light of recent experience". From an African perspective, the crux of the search for a

New York consensus is based on a "selective intervention" paradigm, given the initial conditions of various developing countries, learning from the Asian miracle countries and taking into consideration the implications of the technological revolution.

Moreover, from an African perspective it may be important to note the political implications of the recent Asian financial crisis. These have been noted by a number of people. It has been noted, for example, that the forced change of Government in every affected Asian country except Malaysia between 1997 and 1998 has also given rise to unfortunate speculation within Asia and throughout the developing world, and that, as was the case with the 1982 debt crisis in Latin America and Africa, the Asian financial crisis has been taken advantage of opportunistically to bring about changes in political systems which had outlived their usefulness, especially in Indonesia. Thus political instability in the wake of economic reforms does not seem to be related to Africa's ethnolinguistic fractionalization. And the famous IMF riots which broke out and erupted in the streets of various African capitals in the 1980s are not really an African characteristic.

From an African perspective, the emerging "New York consensus" should be based on selective intervention which takes into account the initial conditions of developing countries, the lessons from the experience of the Asian miracle economies and the implications of the technological revolution

We believe that the African continent continues to suffer from major developmental challenges and that in the process of restructuring and re-engineering the international financial system, the financing of Africa's economic development will need to be taken seriously into consideration and policy measures put in place to effect that development in the future.

CHAIRMAN

Thank you, Mr. Ali. I am sure that all of us share the deep concern you have expressed about the consequences of the crisis on the ongoing structural improvements that have been much needed in the case of the continent of Africa for so long. We have to be mindful, as I emphasized this morning, that when we are talking about a new international architecture and about providing funds to salvage financial institutions in crisis, we should never do so at the cost of diverting funds away from the structural adjustment needs in Africa. With regard to debt relief arrangements, I hope that by the time of UNCTAD X in Bangkok we will have been able to establish systematic arrangements to put debt relief programmes into action. Also, while we are trying to restructure some of our international agencies, I hope that we will take the opportunity to take a serious look at our past efforts in Africa and not ignore the possibility of even more serious marginalization of the African continent as a result of the current crisis.

Let me now go over to our next panellist, Mrs. Joyce Cornell, in New York. As concerns mount about the contagion effects of the financial crisis, Mrs. Cornell, Managing Director of Scudder Kemper Investments, remains optimistic about countries in North Africa and Central Europe. In explaining why she remains optimistic, she will identify some of the factors which have contributed to the insulation of these countries from the financial crisis, and she will explain under what conditions she expects them to continue to be attractive to foreign investors.

MRS. JOYCE E. CORNELL [New York]
Managing Director, Scudder Kemper Investments, Inc.

By way of background, I would like to mention that I am responsible for all the equity investment in emerging markets at Scudder Kemper Investments, which now manages about US$ 240 billion. The money invested is intended largely to provide pensions or retirement income, and Scudder takes the responsibility

for investing this money very seriously. This investment is for people's retirement in the future and thus we and others like us are looking for places to put money where we will get a good safe return. The return on investment is an important aspect of this: we want to invest the money where it will grow and surpass inflationary expectations and provide for a comfortable and healthy retirement.

Also to set the stage, I would like to talk for a moment about definitions. As the Chairman mentioned, I am going to talk a little about contagion from the perspective of where it is spreading and where it will not be spreading. I think we need to think a little bit about the term "contagion": contagion of what? I think there are really two strains of contagion; maybe the first to come to mind is that of financial market meltdown or financial system meltdown. This obviously has been talked about a lot in this meeting and previously. This type of contagion is transmitted by a loss of confidence and culminates in its worst form in a panic, and this is panic not just of foreign investors wanting to withdraw from what they perceive to be a very dangerous environment, but also panic of local investors. One of the things that clearly exacerbated Asian problems at the epicentre of this particular contagion was locals taking their money offshore, and although this is a normal human reaction, it is obviously part of the problem as well. The second type of contagion is not the financial market panic but the contagion that reaches the real economy. One of the characteristics of the present time is global deflation, and this is transmitted exclusively through trade, not through financial market panic.

Let me say that from a financial person's perspective, or from a private sector investor's perspective, we are unfortunately witnessing a very familiar phenomenon; we are in a classic credit cycle and a classic credit crisis. The fact that such a crisis has been commonplace in history and is very recognizable, however, does not make it less painful. Such crises are always terribly painful and traumatic. That said, when times are good, people tend to forget the bad side and forget the risk, and in fact, broadly speaking, no risk is perceived. Well, we rediscovered risk in Asia about two years ago. In the first phase of contagion, investors in particular

began focusing on the possible risks in other places and on unsustainable policies and unsupportable levels of borrowing. That phase of the crisis appears to be just about over now.

The second aspect of the contagion, whereby the crisis spreads to the real economy, is, unfortunately, just starting in our opinion. The credit cycle turn is always characterized by the shrinking availability of capital and shrinking liquidity, and has been particularly aggravated in this crisis by deflation, which is itself the after-effect of massive over-investment, particularly in Asia. If you have, say, twice as many chemical plants as the world can possibly use, then the price of the output of those chemical plants is going to be very low, because companies all over the world are going to be trying to sell whatever they can at any price just to keep the plant open. So you get the export of deflation in the form of really cheap prices for traded goods. This is the method of transmission of the second, and arguably more virulent, form of contagion.

The good news is that a crisis always comes to an end; the bad news is that there is no magic quick solution. Perhaps we were all guilty a year ago of hoping against hope that the IMF would come up with the quick magic pill that would solve the problem overnight. Unfortunately, credit cycles and credit crises do not lend themselves to magic overnight solutions. It takes a long time to get into one, and build up the overcapacity, but unfortunately it also takes a long time to get out of one. What will happen, and what has already started to happen, is that we see more debt-restructuring, recapitalization and reduction in capacity – unfortunately this is not happening very quickly – and when the cycle is complete, a new credit cycle begins. I wish I could sit here and tell you that there is a quick solution, but unfortunately there is none, so we have some difficult times ahead of us yet.

At the heart of what I want to talk about is this: who is escaping this global contagion, particularly the spread of deflation and slower economic growth? Where do investors like Scudder look, and where do we put this precious pension money that we have to protect and to grow? Happily, there are places where we can put this money – in my case in emerging markets – where we

think things are in very good shape, and places that we think are going to continue to largely escape most of the downside of this global credit cycle.

Where are these countries? There are a lot of North African and Arab countries that fit this model – and we have a lot of money in these – notably Egypt, Jordan, Morocco and Tunisia. We also have a little money in Bahrain and Oman. Some of the Central European economies also fit the model; we particularly like, and have a lot of money in, Estonia, Greece, Hungary and Poland, and we have a little in Croatia as well. In view of Mr. Ali's comments about Africa, I would like to say that we have actually more money in sub-Saharan Africa than we do in Asia (I am talking now about a narrow band of sub-Saharan Africa, north of the Limpopo). There are actually some interesting investment opportunities in that part of Africa, and I do not think that we in the private sector are overlooking Africa, where there are ways to make a good return on investment.

What, then, are the characteristics of the places where we are happy to put our money, and where indeed we have been putting more of our money this year? First of all, they are all characterized by good policies that are investment-friendly, and I will specify a few of these in a minute. This is a general characteristic of all of them. There is always a risk, of course, but where the risk is manageable and the return respectable, the rules are the same in all parts of the world. The second aspect of what right now is making a very attractive environment in some of these countries is "euro convergence". This obviously just affects the European countries I named, but all but one of those countries are slated to be part of an enlarged European Union, and this is having a very salutary effect: they are putting in place much more transparent policies and better regulation, which shifts their risk profile from relatively high risk to relatively low risk. This transition makes them very attractive as places for investment, but while it may be helpful to have the crutch and the discipline that comes from the rules the European Union has set down for membership, there is no reason why any country in the world should not implement similar policies for its own reasons. It is the policies themselves that make the investment climate attractive.

To illustrate these policies, I would like to talk about Egypt. Egypt is in fact the country in which we have the largest single amount of money invested at the moment. By the way, we are long-term investors, and we trade very little; we try to figure out what the trends and policies are, we go in carefully and we are there for the very long haul. To get back to why we like Egypt so much – and Egypt is a great example of how to get it right, a wonderful case-study – from the macroeconomic point of view, Egypt is characterized by sound economic management. The fiscal deficit right now is about 1 per cent of GDP and, importantly, the direction is declining. Inflation is about 3.5 per cent and also declining; it may end the year at about 3 per cent. They have had roughly four years now of roughly a 9 per cent productivity gain – this is a really stunning achievement and, from what we can tell from our analysis, the trend looks set to continue.

There is no reason why any country in the world should not implement the kind of economic policies required of potential new members by the European Union, which can transform a country into a low-risk, attractive area for investors

What is producing this productivity gain, and why is it likely to continue? The key here is the shrinking State sector: in other words, privatization. Egypt in the last four years or so has been systematically privatizing large, old, inefficient and poorly run State-owned enterprises and as these have entered the private sector one by one – this is where the huge efficiency gain comes from – Egypt has also liberalized the laws and rules for setting up small businesses. Something we look at everywhere in the world before we go in, by the way, is how easy it is for a small entrepreneur to set up a business; if it take two years of bureaucratic form-filling, that is a very bad sign. What we are looking for is a situation where an individual or a small group of individuals can very quickly file the papers and get started. This is an area in which Egypt has made good progress; they have not

achieved perfection yet, but they are certainly moving in the right direction. There is a lesson here for every country, including the United States, because employment growth does not come from big companies but from new small ones. The creation of the small, typically service-sector, companies that are started by entrepreneurs allows the employees laid off by the restructuring of State enterprises to be absorbed back into the economy.

So, Egypt is managing very well this process of allowing small businesses to get started and at the same time streamlining and getting productivity gains out of the old State enterprises that are now in the private sector. They have created a situation for themselves where they have had 5 to 6 per cent GDP growth for the last four years, and we believe this growth is set to continue for the future, and of course it is the future we are most focused on as we invest our money. What is more, they have achieved this admirable growth despite the Luxor tragedy in their own country and everything else that is going on in the world and that we have been talking about. Not only is government debt shrinking, but, best of all, almost none of that debt is short-term. In times of reduced liquidity and a credit crisis, they are in the best possible shape, with no short-term debt to roll over, and this is something that sets them up well to continue to weather this crisis.

Where the risk is manageable and the return respectable, the rules are the same in all parts of the world: investors are looking for sound macro-economic management in a country – low fiscal deficit, low inflation, GDP growth and little or no short-term Government debt

I want to turn now to the micro situation in the country, which provides the other half of the lesson on getting it right. It is generally an unleveraged market; in other words, the companies in Egypt generally have very low debt, and many are very cash-rich. This is a situation you want to be in when liquidity is tight and interest rates are universally high. You don't want to have to go to

capital markets, but would like to be able to generate your own capital internally, in the case of a company, or have cash on the balance sheet to fund your growth – it always takes capital to fund growth. So they do not have to worry about finding capital at a time when it is going to be tough, particularly for emerging markets, to raise capital.

Overall, companies in Egypt (I am referring to the listed companies that we look at as a financial investor) are growing by about 15 per cent a year. This is obviously a function of the GDP growth, but it is also a testament to the fact that they have solid management. You can have wonderful growth but if you have bad management the company can still lose money and go out of business, so we do look very carefully at the quality of management before we invest.

I would not necessarily argue that a country should set out to achieve very high dividend yields, at this moment in time, but they certainly are helping Egypt, and Kenya too, to take another example. Particularly in the case of Egypt, the high dividend yield means there is less of a tendency for people to migrate out of the market, which is very good from our perspective at a time like this.

A minimum of formalities for starting up a new business, companies with low debt and solid management, and productivity gains following the privatization of State-owned enterprises are all features which attract investors – not to forget the chance of finding a bargain

The Egyptian market overall is inexpensively priced compared to world markets – as a matter of fact most of the Arab markets are cheaper than, say, Asia. People think the Asian market must be very cheap, but it is not really, because what has happened is that earnings have gone down at the same time as prices, so you still may be paying an awful lot for much lower earnings. In the case of the Arab markets, they are cheap but without this negative aspect; they are just good buys. I guess that like many in my job,

and perhaps like the housewife Mr. van Heemstra spoke about, I am a shopper and I like bargains, so we are looking for good value at a good price and Egypt definitely offers that.

Lastly, and this is a very important point, the banking system in Egypt is well regulated and is extremely liquid. Again, in the current situation, this is a wonderful position to be in. Some of the banks have a capital adequacy ratio of up to 20 per cent, and they also have huge hidden reserves and free reserves, so they are not going to need to access capital markets to continue to lend and to grow, and lending is going on apace there because you have this great liquidity in the banking system. I would like to underline that good sound bank regulation is, in our view, key to the prevention of future problems such as the credit crisis we are now facing. A lot of the excess lending happened because there was lax, and sometimes even non-existent, bank regulation from the standpoint of enforcement. This comment is not directed only at the Asian countries but also at the United States and other countries, where I think banking regulation could have been or should have been tighter to avoid the excess and imprudent lending that took place. There is plenty of blame to go around here, but I think, as a representative of the private sector, that if I could make only one recommendation here it would be that banking regulation needs to be greatly improved across the board and globally.

From the private sector investor's point of view, the single most important reform needed is to improve banking regulation across the board and throughout the world

To turn back to the comments that Mr. Ali made, I just want to repeat that good policy is what attracts global private capital. If the environment in a country is investment-friendly, and potential investors feel that their rights as investors are on an equal footing with the locals, that the country is run well from a policy and economic policy standpoint, and that they have a good chance of making a reasonable return on their investment, the capital will

come in. For example, we have money in Kenya now, as I mentioned, and if Kenya succeeds in sticking to the IMF prescriptions, I am sure we will invest more money there. We have money in Botswana, where we are very comfortable with the policies, and we have some money in Ghana, but in all these places, we are watching policy evolution. There are some very good things to look at in the region, but I do not want to generalize about any area, be it Asia, Africa, Europe or wherever; there is always a variety of situations within each area, and we spend a lot of time trying to get a clear picture of them.

Good policy attracts global private capital: if foreign investors feel they are on an equal footing with local investors, that the country is investment-friendly and well-run, and that they have a good chance of making a reasonable return on their investment, the capital will come in

I would like to close by saying that I think we still have a little further to go in this down part of the cycle, but there is light at the end of the tunnel, and there have already been some allusions to it here today. Thailand, for example, is beginning to stabilize, as the IMF prescriptions take hold; none of these prescriptions are fun – none of the corrective phase of the downside of a credit cycle is fun and indeed it is torture – but the world will get through this crisis as the world has got through many in the past, and those countries that have the soundest policies are going to fare the best and emerge the least scathed, and they will be the countries that continue to attract capital like ours.

CHAIRMAN

Thank you, Mrs. Cornell. I noticed that throughout your presentation, in the audience in Geneva, Ambassador Zahran from Egypt was constantly beaming, and rightly so. I think you have

made Mr. Ali feel much much happier too, by confirming that at least Scudder is looking into sub-Saharan investment and already invests more there than in Asia.

You have also echoed the comments made by Ambassador Kreid this morning about the need to attract foreign investment in order to come out of the crisis, as well as the need for an investment-friendly climate which could actually be very well supported by the classic macroeconomic fundamentals – strong savings, a low budget deficit, strong fiscal monetary discipline, contracting public sectors, privatization and things like that. I think it is quite encouraging that a representative of the private sector takes note of all these kinds of macroeconomic fundamentals as they manage the funds that are much needed in various countries.

I would like now to turn to our next panellist, Mr. Yves Berthelot. Europe has not been immune to the effects of the crisis, although the impact on most countries has been fairly muted so far. However, the situation in the Russian Federation, where the contagion effect of the Asian crisis has exacerbated a home-grown economic crisis, is a particular source of concern. Mr. Berthelot, the Executive Secretary of the United Nations Economic Commission for Europe (ECE), will talk on the impact of the crisis on Europe, particularly on transition economies, and suggest specific policy options available to Governments and international organizations.

MR. YVES BERTHELOT
Executive Secretary, Economic Commission for Europe

Like my colleague Mr. Ocampo, I would like to thank UNCTAD very sincerely for this exercise. It is a good example of useful and meaningful inter-institutional cooperation.

I will address successively the crisis in the Russian Federation, the risks in Central Europe and the perspectives in western Europe at this juncture, and will conclude with some policy recommendations. I shall say little on the Russian situation,

not because it is unimportant, but because it is so important that we at the Economic Commission for Europe have jointly produced with our UNCTAD colleagues a special paper on the subject, which has been presented to the Trade and Development Board, in another example of good cooperation.[2] The paper addresses what in the Russian crisis could be attributed to the Asian crisis, to specific Russian weaknesses and to systemic problems.

The Russian economy was severely affected by the fall in commodity prices and the increased cost of raising finance from abroad, which are two consequences of the Asian crisis. However, the underlying causes of the crisis are deeply rooted in the weaknesses in the country's economic structure, institutional framework and political processes. Indeed, the Russian Federation curbed inflation after 1995 and maintained a relatively stable exchange rate by pegging the rouble to the dollar. It also liberalized external trade and capital movements and privatized most State enterprises. But it did not conduct in-depth institutional reforms. In particular, the lack of corporate laws and restructuring of financial institutions meant that privatization mainly benefited insiders who had neither the incentives nor the capital to restructure their enterprises. Also, the lack of reforms in an extremely complex fiscal system and the consistent problems with tax collection compliance rates led to a considerable budget deficit, financed in great measure by foreign short-term capital attracted by the expectation of high profits. No financial resources were left for non-public needs and the rate of investment declined further, reducing production and the tax base and compromising the future. It has to be underlined that the premature opening of the country's financial markets to foreign capital left it highly vulnerable, with the possibility that domestic financial difficulties and setbacks would be amplified into a full-blown currency crisis – and this, in fact, is what happened in August this year.

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[2] "The Russian crisis", which will be published in early 1999, can be viewed at the UNCTAD website (http://www.unctad.org).

The circumstances described for the Russian Federation could, *mutatis mutandis*, occur in other countries of the Commonwealth of Independent States, with the added consequences of the collapse of the Russian market, their main export market.

As for the risks in Central Europe and the Baltic States, the direct effects on GDP growth in 1998 have been small because trade links between these countries and Asia are generally weak. The same applies to most countries vis-à-vis the Russian Federation, although the Baltic States are more severely affected, as are certain industries (such as food and pharmaceuticals) and regions (particularly in those countries which border on the Russian Federation or Ukraine).

The Russian economy was severely affected by the fall in commodity prices and the increased cost of raising finance from abroad, which are two consequences of the Asian crisis, but the underlying causes of the crisis in the Russian Federation are the weaknesses in the country's economic structure, institutional framework and political processes

The difference is significant between countries which were able to redirect their external trade towards western Europe after 1990 and which benefited from association agreements and those which were unable to do so because they had no such agreements or were exporters of agricultural products which the European Union was not ready to accept.

Since the outset of the Asian crisis, and even more so since the Russian crisis in August, all the economies of Central Europe and the Baltic States have been affected by a deterioration in their access to international capital markets:

- they have seen large increases in risk premiums on external borrowing;
- since August, virtually none have issued external bonds or equities, or obtained syndicated loans of any size;

- corporate borrowing from abroad rose rapidly in 1996 and 1997 but there has been virtually none in 1998; and
- the credit ratings of some countries (Croatia, Romania, Slovakia and the Russian Federation) have been lowered.

Nevertheless, these developments have yet to appear in the official statistics, and capital inflows into Central and Eastern Europe in the first half of 1998 have held up quite well. Some portfolio inflows were attracted by high interest rates, and foreign direct investment remained buoyant. Foreign direct investment held up and funded about half of the aggregate current account deficit in the first half of 1998 (although most of it still went to the Czech Republic, Hungary, Poland and, to a lesser extent, the Baltic States), but can this continue? The answer depends on how the following elements interact:

- foreign direct investment in 1998 is the result of decisions taken much earlier, and current uncertainties about growth, exchange rates, etc. could lead to smaller inflows next year;
- foreign direct investment in Central and Eastern Europe is still influenced by privatization programmes – if these go ahead, such investment could still hold up;
- as far as the candidates for membership of the European Union are concerned, the export of "EU credibility" may also help to maintain foreign direct investment from the West.

The direct effects of the crisis on GDP growth in Central European and Baltic countries have been small because trade links between these countries and Asia are generally weak, but their economies have been affected by a deterioration in their access to international capital markets

Nevertheless, the prospects for financing current account deficits in Central Europe and the Baltic States are now clearly worse than they were six months ago, and this is likely to lead to

lower growth rates in 1999. How much lower will depend very much on developments in western Europe and especially in the European Union – if growth slows, then the exports of the Central and Eastern European countries will be affected and the external constraints on their own growth will be amplified, as they would be by an increase in protectionism. But if western European growth is maintained – or, even better, boosted to an average rate of some 3 per cent – then the prospects for the transition economies would be much more secure.

Foreign direct investment in Central and Eastern Europe is still influenced by privatization programmes, and, in the case of candidates for membership of the European Union, by "EU credibility"

This raises the question of whether western Europe can remain an island of stability and security in the midst of world mayhem. Although the United Kingdom is well advanced in the cycle and is revising its growth perspectives downwards, continental countries of the European Union are still in the first phase of the cycle and, importantly, are protected by the euro from speculative attacks which would have affected some of them, as is more often the case when the dollar decreases vis-à-vis the deutsche mark. These are positive elements, but several factors may reverse the present moderate optimism.

The banks which faced losses in Asia and the Russian Federation will announce reductions in their profits and the credit crunch emerging for the corporate borrower in the United States could extend to Europe. This is not yet the case but there is already some tension in the inter-bank market. The United States is now on the downside phase of the cycle, which could be aggravated by the fall in exports to Asia, by its trade deficit, which has just hit historic levels, and by the indebtedness of households, which is at its highest since the Second World War. The decrease in interest rates gives hope for a soft landing.

In this context, it is not surprising that yesterday the European Commission announced a downward revision of its forecast for GDP growth from 3.2 to 2.6 per cent, (independent institutions forecast GDP growth of between 1.7 and 2.0 per cent). This, at least, leaves Europe growing, and many observers take much comfort from that, but growth is now decelerating towards rates that imply no further improvement in unemployment, and possibly a worsening of it. This is an alarming prospect for economies which are still in the early stages of an upswing. The new European Central Bank has set an inflation target of 2 per cent or less, which, given the margin of measurement error, is roughly equivalent to zero inflation at the upper limit. If, as seems likely, social democratic Governments are unwilling to see a resumption of further increases in unemployment, a clash between the tight monetary policy of the European Central Bank and Governments unwilling to check the growth of their budget deficits will become increasingly likely, with a consequent imbalancing of the fiscal and monetary policy mix.

If western European growth is maintained or boosted, the prospects for the transition economies will be much more secure

In drawing policy conclusions from the current crisis I want to be careful to avoid the trap of pretending to know all the answers or to know how this new global economy really works. Here, I would reiterate Mr. Ocampo's call for some humility in this respect, in contrast to the triumphalism with which the so-called "Washington consensus" has been presented since the early 1990s.

In the Russian Federation, the resolution of the deeply rooted crisis will require time and the proper sequencing of privatization and liberalization, together with institutional reforms and industrial restructuring. This requires a plan (or a strategy, if the word "plan" raises fears), which can only be drawn up by the Russian authorities and which will require technical assistance and financial support from the international community. This is also valid for

other countries of the Commonwealth of Independent States where reforms are still far from being completed and which have been severely hit by the Russian crisis.

In Central Europe, the reform process should continue whether it is supported by the expectation of membership of the European Union or not. In particular, as occurred in Poland, the privatization process should continue, as it has proved to be essential in attracting foreign direct investment.

Western Europe is a key market for Central European countries, and if it was more accessible to the countries of the Commonwealth of Independent States, it would help them immensely. This leads to two essential conclusions. Europe has to resist the protectionist pressures which could emerge if the slowdown is more pronounced and it should also alleviate the obstacles which remain, particularly for countries of the Commonwealth of Independent States. This would be easier if growth were to return to the expected level of about 3 per cent. It is time to emphasize growth rather than inflation. There is a case for a reduction in interest rates and for a flexible interpretation of budget criteria, but this is delicate when the credibility of the euro is the first guarantee of economic stability.

CHAIRMAN

Thank you Mr. Berthelot, for your clear summary of the economic conditions in Europe. In a nutshell, I think Europe remains one of the healthier spots in the world economy at the moment, and it is really good news that leaders in Europe have decided to participate in what is known as "global demand management", to produce counter-cyclical measures that would address the deflationary situation in the world economic system.

I would like now to turn to our last panellist, Mr. Robert D. Hormats. The financial crisis has generated considerable discussion on what the appropriate policy response should be. Many proposals have focused on reforming the international financial system. Stanley Fischer, the First Deputy Managing

Director of the IMF, has recently argued that financial and corporate inefficiencies were at the epicentre of the financial crisis. Others agree with this view and suggest that initiatives to strengthen the international financial system should include the private sector. Mr. Hormats, Vice-President of Goldman Sachs and a former senior official in the United States Government, will react to some of the proposals to strengthen the architecture of the international financial system, and give us his views on the role that the private sector might play in this process and on the implications for developing countries.

MR. ROBERT D. HORMATS [New York]
Vice-Chairman, Goldman Sachs International

I have enjoyed the interesting presentations that have been made this morning and I would like to try to respond to a few of the questions that have been posed and discuss some of the proposals that are now being suggested for changes in the architecture of the international financial system. Let me say at the outset that this is a long-term problem. As other speakers have indicated, it is not a problem that is going to go away soon. Mrs. Cornell underscored that it is part of a longer-term set of cycles in the credit markets, in which capacity is increased very dramatically and then has to be brought down over a period of time, while the debt has to be worked off. So it is important to underscore the point that there are no quick answers here. Many of the answers involve some measure of pain, in downsizing certain sectors of economies, reducing the number of banks, restructuring banks and restructuring corporations, which are critical elements of the process that has to go on in a number of countries. This is not something that can be done immediately, but there are some interesting ways of addressing the problem.

First, let me talk about the fact that some countries have already made major efforts to do these things. In her presentation, Mrs. Cornell made the point that a number of countries have taken measures to restructure their economies, to strengthen their

banking systems, to improve the productivity of their corporate sectors and to improve the regulatory environment, and many of those countries have been rewarded for their efforts by capital inflows from her funds and others. So, good economic policy is rewarded by higher rates of growth, less volatility by and large, and more sustainable capital inflows. One of the difficulties arises when people look for short-term fixes that avoid making the fundamental changes necessary to strengthen the economic institutions and political institutions that are the bedrock of sound long-term economic growth. It is important to note that a number of countries have seized upon the painful crisis now under way to make important changes in their own economies. The Republic of Korea is an example of a country which has been hit by a major crisis and is beginning the process of structural reform in banks and in the corporate sector. It has some way to go yet, but the process is under way and President Kim has been a strong advocate of it. I think, Mr. Chairman, that Thailand, your country, has been doing a number of very important things, and is another country that has seized upon this crisis to make major and important changes that will lead to a stronger economy over the longer term.

Difficulties arise when people look for short-term fixes that avoid making the fundamental changes necessary to strengthen the economic and political institutions that are the bedrock of sound long-term economic growth

The People's Republic of China, which has not been hit by the crisis in the same way as other countries have been hit, has understood that there are lessons to be learned from this crisis in terms of strengthening the banking system, dealing with the problem of non-performing loans and accelerating the restructuring of some State enterprises. These kinds of changes are very important. A number of countries in Eastern Europe are making efforts to continue their reforms, and even though they are close to Russia they have not been as badly hit as some other countries by

the crisis. In Latin America, even though bond spreads have widened and there is a major capital constraint, a lot of changes were made after the Mexican crisis of 1994–1995 to strengthen banking systems. You may recall that the banking systems were weak in many parts of Asia and were a major part of the problem. Latin America, Argentina, Brazil, Chile, Mexico and a number of other countries actually made a lot of progress in addressing the problems of their banking systems a few years ago and their banking systems today are in much better condition to deal with this problem than they would have been had this crisis hit a decade ago, when their banking systems were considerably weaker.

Let me now try to discuss some of the specific proposals that have been raised to deal with this problem. First, there is the notion of some type of controls on capital; in some cases there are suggestions for limiting or moderating the inflow of short-term capital, while in other cases, there are suggestions for more restrictive measures on the outflow of capital. It is important at this point to make one general point: there is a major credit crunch today and a number of the proposals that have been made to limit the inflow of capital to emerging economies may be appropriate for a period of time. I would urge countries not to push them too hard at the moment, when countries are trying to get more capital inflows. Even countries like Chile, which had measures to slow the growth of short-term capital, are dismantling such measures because they want capital at this point. So timing is important here, and while we need to figure out how to buffer countries againt the volatility of short-term capital, the problem at the moment is to ensure that capital can resume its movement into some of these countries. Some steps that could help to reduce short-term capital inflows have been discussed, but I think this may not be the right time for them.

The crisis has highlighted the need to strengthen the banking system, tackle the problem of non-performing loans and accelerate the restructuring of some State enterprises

The other aspect of capital controls or limitations is on the outflow of capital, and I think here there is a similar risk. I do not want to comment on individual countries' actions in this respect, but bear in mind that if investors considering an investment in your country believe that there is a chance that your country, if it gets into trouble, is going to put restrictions on the outflow of capital, then those investors are not going to be very enthusiastic about putting money in there in the first place. Talk about a wider use of capital controls on the outflow side – particularly unilateral ones that surprise investors – can have a discouraging effect not simply in the countries that impose them but on other countries too, if investors believe that the rules of the game are changing and that this practice is going to become more widespread. This is really a word of caution, as very few countries have actually imposed such restrictions, but there is a concern among some investors that the practice could spread.

It is also important to realize that if there are measures to limit the inflow of capital to avoid the rapid movement of short-term capital, they should not be a substitute for making the major changes in banking and financial systems, and the other domestic changes that are needed. If inflow restrictions on capital are really to be successful, they need to be part of something much broader and more effective in dealing with the domestic problems. While Chile is an example of a country where measures to reduce the short-term inflows of capital have been successful, I would argue that Chile had a successful economy not because of those measures but because it undertook a number of very successful reforms in banks, social security, and regulation and supervision. I think most Chileans would agree that it was their domestic reforms that enabled Chile to be the success story that it is, but even with these measures to reduce the inflow of short-term capital, Chile has seen a lot of volatility in exchange rates and lot of volatility in the movement of financial assets. While there is talk of capital inflow restrictions, countries should not accept these as a kind of panacea or answer to their problems.

Let me now talk about the question of exchange rates, because there has been a similar discussion about what the right

exchange rate regime is in this environment. How do we get more exchange rate stability? How do we avoid exchange rate rigidities? Exchange rates are very complicated and there is no magic answer here. As we have seen, the two most significant currencies in the world, the US dollar and the Japanese yen, have seen enormous volatility over the last several months – remarkable volatility when you consider the size of the economies and the flows that are involved in these erratic movements in currencies. The question then is how you get a more sensible international exchange rate regime, particularly for smaller economies that are very vulnerable to currency volatility, which has an enormous effect on their domestic economies.

Restrictions on the inflow or outflow of capital can drive away investors, and are no substitute for making any major reforms necessary in the banking system

I will just make a few suggestions for the moment, as the debate is just beginning and it will continue over a period of time. Whatever exchange rate regime a country chooses, it has to be consistent with its domestic policy and domestic financial institutions. If a country has chosen a fixed-rate regime (I am leaving the currency board idea aside for a moment), the central bank might on occasion have to raise interest rates very dramatically to hold that regime on a steady basis against the dollar or the yen or whatever currency it has chosen as the anchor. So you have to make sure that there is a consistency between what you want to do with your currency and what you are planning to do with your domestic economy. Those countries or territories that have chosen currency boards, such as Argentina, Bulgaria, or Hong Kong, China, have accepted this as a way of creating a permanent link between their currency and the dollar (in the case of Argentina and Hong Kong, China) or the deutsche mark (in the case of Bulgaria). They have to allow depreciation in asset values and higher interest rates, as in Hong Kong, China. If countries are not

willing to make these changes, then a currency board is not the right answer.

I tend to believe that for most countries who do not want a currency board, some greater degree of flexibility in exchange rates is probably the most acceptable kind of regime. Countries like Israel, Mexico and South Africa have developed what I consider a managed float; it is not that they have not been vulnerable to volatility, but rigidities did not build up in those economies' exchange rates as they did in the case of, say, the Thai baht or the Korean won. Ultimately, the latter currencies became overvalued because they were linked to the US dollar, which was appreciating in value, and that undermined the current account balances of these countries. In a way, the notion in the market that these currencies were going to remain stable was a moral hazard in itself, because it convinced some lenders that they could lend without worrying about the devaluation of the currency and it convinced some borrowers in these countries that they could borrow and not worry about the devaluation of the currency. When the currency depreciated and they had not hedged, they were left with very onerous repayment responsibilities. Deciding on the right exchange rate is not an ideological question to my mind, but a question of pragmatism. Different countries will reach different conclusions; some very small countries may conclude that a national currency is a luxury that they cannot afford and will over a period of time perhaps accept dual currencies, where you have the dollar or the ecu or the yen playing a more active role in their domestic economies. A number of academicians have proposed that more countries should use the currencies of large countries to avoid currency instability, although the prospects of this happening for most are still some way off.

A flexibly managed float exchange rate regime does not give full protection from volatility, but it can help to prevent the kind of build-up of rigidities in an economy's exchange rate that took place in the case of the Thai baht or the Korean won

Banking and financial sector reform is a very important issue. There have been a number of proposals for big new changes in the global architecture. I do not think these are likely. I do not think it is possible for us to have a world central bank or one giant regulatory institution, but there are some practical proposals that I do think are wise. First, Paul Martin, the Minister of Finance of Canada, has proposed a very sensible idea, which is to have a peer review among regulators, that is to say regulators in various countries will work with their counterparts in other countries to judge and improve the quality of the regulatory system, or the quality of the supervisory system for banks and financial institutions. This could be done globally or regionally, and could be coordinated by the Asian Development Bank, the African Development Bank, the American Development Bank or other institutions, including the Bank for International Settlements (BIS).

It is unlikely that a new giant regulatory institution will be created: among the practical proposals being put forward are proposals for the introduction of a system of peer review among regulators, the use of the IMF or BIS to carry out ex ante reviews to prequalify countries for assistance, and greater use of the guarantee capability of the World Bank and some of the regional banks to improve countries' access to global capital markets

Second, there are ways in which the IMF or the BIS can do *ex ante* reviews, that is to say, instead of waiting for a country to move into crisis, the IMF or the BIS could take a look at countries' policies and prequalify them for assistance. This is the way it is done with banks in the United States and Europe, where banks that want to use the window of, say, the Federal Reserve in the United States must prequalify. The Federal Reserve certifies them as is being well run, so that when there is an emergency they can more actively move ahead and take advantage of the opportunities by

drawing on the window of the Federal Reserve. Instead of waiting for a crisis to occur, there is a more proactive approach to problems. I think this proposal, and Secretary Rubin of the United States has made a similar proposal on precautionary financing, offers a lot of opportunities.

Let me just very quickly go through a couple of other suggestions. One concerns the role of the World Bank. I think that the World Bank and the regional development banks can play a greater role in helping countries that no longer have access to global capital markets to get more access for worthwhile projects. The World Bank and some of the regional banks have guarantee capability, which could be very useful for getting investors who are cautious about loans (particularly long-term infrastructure loans) back into these countries. It may be a temporary or transitional device, but it can be very useful in certain circumstances. The Government of Thailand, for instance, has used it very recently and I think there are others that can do so as well.

My last point relates to humanitarian assistance, which is very important at present. A large number of countries have suffered badly during this crisis. Indonesia, in particular, has suffered enormously and a large number of people have been put back into poverty who were actually doing quite well for a while. To help countries to undertake the sorts of reforms that are needed it may be helpful to help those who are most adversely affected. It is important for the international community to demonstrate that it is not only pushing countries to make economic reforms but that it is also prepared to help those countries which are most harmed by those reforms.

CHAIRMAN

Thank you, Mr. Hormats, for your presentation, and particularly your comment on the ongoing efforts to create a new global financial architecture that should not necessarily be embodied in a single huge institution. Your suggestions to make use of peer

surveillance or the guarantee facility of the World Bank are very pragmatic, and could be put into action quite soon.

I now open the floor for general debate.

REPRESENTATIVE OF INDIA [New York]

My first question is directed to Mr. Hormats. While I agree with him that countries should not put any restrictions on the outflow of capital, I wonder whether it would not be prudent to build up some institutional arrangements to discourage outsiders who make investments in those countries from withdrawing their investment at an early stage, as this can create a situation of panic. This is not merely a hypothetical situation, but one we witnessed in my country in the late 1980s and early 1990s, when the bulk of our foreign exchange reserves were built up with the support of investments from non-residents. When the panic button was pressed, they started withdrawing their deposits and created an even more complex situation. What institutional arrangements could be set up to avoid this type of panic situation?

My second point is not a question but rather a suggestion for the consideration of the panellists. One of the principal reasons for the crisis has been an over-dependence on short-term credit in order to avoid an immediate crisis, which is invariably closely associated with deficiencies in the banking system. Would it not be possible to have some uniformity in the banking regulations? Perhaps the regional banking organizations, the Asian Development Bank or African Development Bank or some other institution could be entrusted with developing some international norms that could be useful in a crisis like this.

The third and most important issue I would like to raise is that no reform or liberalization can begin to be undertaken without adequate institutional support. How then are we to organize the institutional arrangements side by side with the introduction of economic reforms and the process of liberalization?

MR. ROBERT D. HORMATS [New York]

The question posed by the representative of India is a very interesting one. He is raising concerns that a number of people feel about the fact that capital can be very volatile, and I would just like to make a couple of general points and then a very specific one.

First of all, the outflow of capital can occur if confidence deteriorates and it can occur very rapidly. There are no perfect ways of dealing with that. Controls on the outflow of capital have not been used very much in the past because they can make it very hard for countries to get new capital in, and so it is not a device used very frequently. But I think there are ways of addressing this problem, and the provision of information is one of them. Frequently, when investors feel that information is asymmetrical – that is to say, they do not really have as much information as they need and they think that insiders in a country have more – they tend to be particularly nervous, so better transparency reduces the risk or the "doubt premium" that some markets have. If they don't believe they have the information, investors are more nervous than if they do have it. It is better to provide information – even if it is bad news – than to hide the problems, since investors get very nervous if they feel they don't have all the facts, and this makes them even more likely to pull their money out in panic. They do this because of those big question marks about numbers and about data, and this happened to a degree in the Asian crisis as well, although it was certainly not the only reason that they withdrew their money.

Greater transparency reduces the risk or "doubt premium" that some markets have, since investors get very nervous if they feel they do not have all the facts

The second point I would like to make is that it is not only foreign investors who withdraw their money; sometimes, domestic investors are the first to pull out, because they may have more

information than the foreign investors do. Keeping capital stable depends both on making sure foreign investors feel comfortable with the domestic investment environment and on keeping domestic citizens comfortable with the economic environment.

Keeping capital stable depends on making sure that both foreign and domestic investors feel comfortable with the domestic investment environment

The question of how to deal with short-term credit volatility is important in terms of bank regulation. There is a lot of room for improvement, both in the industrialized countries and in the emerging markets, in the way bank examiners look at short-term credit risk. On the outflow side, perhaps bank examiners need to be much more careful in looking at the risks involved in some large-scale short-term lending, both to emerging countries and to other highly leveraged asset managers in the industrialized nations as well. It is also true that in the emerging markets a much more rigorous set of prudential standards could be applied to reduce the degree to which individual banks or corporations – particularly banks – get involved in large-scale exposure in hard currencies or outside currencies, as well as domestic short-term exposures. In the case of the Russian Federation, the problem was not just external exposure, it was the exposure of domestic institutions to very volatile short-term financial assets. Prudential standards of regulation in emerging and in industrialized countries could help to avoid these large build-ups of short-term liabilities that have proved to be so disruptive. Such regulation is not a perfect answer, but I think that is the direction the process will and should take.

Prudential standards of regulation in both emerging and industrialized countries could help to avoid the build-up of short-term liabilities that has proved to be so disruptive

MR. BERNARD PETIT
European Commission for Economic and Trade Cooperation

After listening to the various panellists, it seems to me important to look at the way in which the international community and the international donor community can adapt their cooperation strategy so as to better respond to the risks which exist and the inadequacies in the international system which have become clear in the course of this crisis.

Firstly, the various analyses have shown us very clearly that is necessary to continue to actively support multilateral liberalization efforts. However, at the same time they indicate that it is essential that we continue to support regional efforts at economic integration, particularly those undertaken by developing countries. These processes can make a major contribution to stabilizing the economic environment and to ensuring the credibility and continuity of the reforms undertaken by many countries. In addition, for developing countries, these processes can constitute an appropriate stage before full integration into the world economy.

Efforts by developing countries to achieve regional economic integration can make a major contribution to stabilizing their economic environment and to giving credibility to their reforms

Secondly, and speakers have already said this, this crisis does not call into question the need to continue with economic institutional reforms. On the contrary, what it does is confirm the need to make further progress in this particular direction. However, it also highlights the need to implement a second generation of reforms which will follow on from the initial stabilization phase. This means tackling problems such as the way in which the financial system operates, supervision of the banking system and the administrative and institutional capacity for

implementing follow-up in the best and most transparent conditions possible. In the same way, however, the crisis highlights very clearly the absolutely essential need to ensure that these reform programmes are part of a long-term vision. There are many consequences which follow on from this, particularly with respect to consistency between the economic and social aspects of the development process. There is also a need to take into account the progress achieved by political liberalization processes, since such processes quite frequently go hand-in-hand with economic liberalization. Generally speaking, we have to ensure that economic reforms are politically and socially sustainable. If this is to be achieved, we have to follow an approach which takes into account the constraints and potentials of each individual country and each individual region, so the approach has to be different depending on the country and region. There is actually no single model which is applicable across the board to each and every country and region.

Donors prefer to operate in a political environment where democratic principles, human rights and the rule of law are respected and where good governance prevails

Thirdly, bearing all this in mind, donors are more likely to achieve their objectives if they operate in a political environment where democratic principles, human rights and the rule of law are respected and where good governance prevails. Equity and the rule of law, a country's institutional capacity for managing resources properly, transparency and measures aimed at preventing and eradicating both passive and active corruption are all part of this overall good management or good governance. However, such an environment has to be positively created, that is, one has to stress the contribution that donors can make specifically to achieving this in the developing countries. We in the European Union have been trying to include these aspects in our renegotiation of the terms of the Lomé Convention.

Lastly, the crisis which erupted in Asia has obviously had extremely negative consequences in terms of increasing poverty. Millions of people have fallen into, or fallen back into, a situation of extreme poverty. The crisis in this way is gradually undermining the efforts which have been made by the international community to reduce and eventually eradicate poverty throughout the world. Inevitably, the crisis has been contagious, since the world economy has become more and more globalized and more and more interdependent, and therefore the consequences of the crisis in Asia are likely to exacerbate poverty in other regions of the world as well. This is particularly true for countries where the institutional framework was already inadequate and where Governments were unable to implement policies effectively. Therefore, there is a very considerable challenge inherent in this situation and it has to be met by everybody involved in development and in international cooperation. Everyone involved will have to take the measures which the situation requires to avoid a further exacerbation of marginalization and the exclusion of countries and particularly of the most vulnerable groups within countries.

The economic and social constraints specific to developing countries must be adequately taken into account in multilateral trade negotiations

I draw two basic conclusions from these thoughts, Mr. Chairman. The first is that there is an absolutely essential need to ensure that trade and development continue to be together on the international agenda. Economic and social constraints which are perhaps specific to developing countries must be adequately taken into account in multilateral negotiations. This means that there has to be a reasonable amount of flexibility accorded to the developing countries, and I refer here to flexibility which respects, of course, the basic principles of the international trading system.

My second conclusion concerns the issue of official development assistance. We cannot but see that there is no

particular sign of a reversal in the downward trend in the levels of official development assistance, and in a situation where people are cutting back on their budgets and more and more frequently having to face queries from the public about its real usefulness, this is inevitable. After all, there are constant violent conflicts throughout the world, and in these circumstances people do start querying the use of aid. People have suggested that private financial flows might replace official State aid, but this now seems unlikely. Over the last two years, levels of private financial flows have been such that it has become only too clear that, at least with respect to the poorest countries in the world, there is absolutely no chance of private investment becoming a substitute for official development assistance – at least not unless we get this more conducive atmosphere to investment that many people have been talking about. However, if we are going to bring about such an atmosphere, and I agree it is essential, the developing countries, particularly the poorest developing countries, will have to continue to benefit in the meantime from significant levels of official development assistance from the international community. More than ever before, this is economically essential, politically essential and, indeed, essential at the human level as well.

Since there is absolutely no chance of private investment becoming a substitute for official development assistance in the near future, the developing countries continue to need significant levels of such assistance

REPRESENTATIVE OF INDONESIA [New York]

My question is directed to Mrs. Cornell, whom I wish to commend for her excellent presentation. Mrs. Cornell mentioned that good policies that are investment-friendly bring in capital. Now, before the crisis, we in South-East Asia were always praised for our good policies, our 40 per cent savings rate, our sound fiscal policies and

our very friendly investment policies, including the absence of capital controls. In fact, our investment policies were so friendly that we were inundated with capital. So, of course, when Mrs. Cornell described Egypt, some comparisons between Asia and Egypt came to the fore; she mentioned the low debt ratio in Egypt, and we are famous in South-East Asia for our high leverage. Mrs. Cornell also mentioned the banking system; after the crisis, it emerged that there were a lot of problems with our banking system.

My question, then, is on the difference between portfolio investment and commercial debt. Of course, portfolio investors are interested in high rates of dividends and so on, because they are investing in companies in various countries. Now, commercial debts are actually loan capital but if we look at what happened, these commercial loans were perhaps worth twice as much as portfolio investment in 1996, but they were also probably the first to move out when confidence was lost. We also had, by the way, very high investment ratings from rating agencies. So, my question is whether there is a difference in the investment strategies of portfolio investors and the commercial bank loans and, if so, whether this is one of the reasons that confidence suddenly disappeared on 2 July 1997.

MRS. JOYCE E. CORNELL [New York]

As regards your observation that for a long while Asia was viewed as an optimal place in which to invest by many, I think obviously that was the case, and I think that Asia basked in this praise for so long that not only the Asian policy makers but also a lot of foreign investors just forgot to look very hard. They just took this view as an absolute truth and did not watch everything that was going on, and that is always a mistake when you are an investor, or for that matter a policy maker. But I think that the nub of this is that getting it all right is actually an extremely difficult thing to do and that is why world society has not got it all right yet. If it was so easy, we would have figured it out a hundred years ago and there

would be no more problems! But the fact is, the economy is very complex and dynamic, and we can only hope that the world will become wiser as time goes on. Asia had a lot of things right, but, speaking as an investor, we began to see the problems two years ago, and we did talk about it but nobody wanted to listen because everybody was convinced that it was a miracle in progress and it was really heresy to question a miracle. One thing that escaped attention was the excessive bank debt, which for us was very frightening, particularly since it was premised on the assumption, as Mr. Hormats said, of a currency in an everlasting currency relationship. We could see that this was potentially a very scary problem. It is true that the savings rate was high, but if you stood back and thought about it, this excessive borrowing had the potential to overwhelm any savings – the debt was far in excess of any savings – and you realized that the greater issue was that risk, not the comfort in the fact that the individual was saving a little more.

One of the warning signs in Asia was the excessive bank debt: another was the unintelligent use of savings. But few people cared to question the "miracle in progress".

The challenge facing us as an investor, and facing policy makers too, is to decide which are the more serious, more threatening or more positive elements in the overall picture. This debt crisis that we are all living through now is, we hope, going to make us all smarter next time. It may have been true that those loans at one time offered a higher return than a stock investment if you just took a snapshot of a minute in time, but as an investor or policy maker you have to look further. You may be able to say, "Today, 22 October, I will make more on this debt instrument than on this equity instrument," but that is only if you assume that everything will stay the same; but the world does not sit still, and economies do not sit still, so you have to look ahead and spot the potential hazards. So that is the way we looked at the situation;

there were short-term investors or people maybe who were too caught up in the mythology of the miracle to really ask any questions, but they paid a heavy price – I mean investors paid a heavy price, but not as much on a human level, of course, as the citizens of Indonesia.

I want to make an observation about rating agencies. As an experienced investor, I think I speak for a fair number of my fellow investors in viewing the rating agencies as something of a lagging indicator. Once they have figured it out, it is usually pretty well known and you have already adjusted what you are doing. I know that some of them are getting better, but rating agencies tend to be something of a "rear-view mirror": they tend to be much more backward-looking, whereas policy makers and investors need to look ahead much more.

Rating agencies tend to be something of a "rear-view mirror", telling you what is behind you: but investors and policy makers need to be looking ahead

There is one thing I would say about savings rates; every society, to prosper, needs a certain amount of savings, but there is such a thing as too much savings. I think that this is oddly enough one of the contradictory hazards we saw in Asia; we saw excessive savings, because when you get too much it cannot be deployed well, and when it is not deployed well it is wasted. If you want an efficient return on capital, and as investors we do – and as developers of economic policy in countries I would think you would want that too – you want to use your capital to best advantage. One of the warning signals we saw in Asia, interestingly, was a low return from the unintelligent use of savings. Still, this is a complex problem we are dealing with, and I guess the bad news is that we will not have all the answers next time either; there will always be something to learn.

REPRESENTATIVE OF INDONESIA [New York]

I would like to comment very quickly on the tendency to underestimate risk and now, perhaps, a tendency to overestimate the risk, as the rating agencies are probably still looking in their rear-view mirrors. I am reminded of an article I read, sometime during the boom in the mid- 1990s, about an Asian country, which I will not name; the article had a long list of all the things that were wrong in this country at the time and ended by saying you would be mad to invest in this country – but you would be even more mad if you didn't. For me, this story typifies the attitude which prevailed during the boom years in Asia.

AMBASSADOR BOZORGMEHR ZIARAN (ISLAMIC REPUBLIC OF IRAN)

May I congratulate the Secretary-General of UNCTAD for his innovative undertaking in arranging this video conference, which has narrowed the geographical gap between Geneva and New York and made it possible for us to see our good old friends on video. Mr. Chairman, mine is a comment not a question: "Every failure is a prelude to a success", says an old Persian expression. The recent financial crisis is, one may rightly reason, no exception to this maxim.

The first two days or so of this session of the Board and today's High-level Segment have provided us with a propitious opportunity to review the current situation and trace the root causes of the crisis. Much has been said and much remains to be said, for such financial upheaval certainly has widespread and enduring economic, social and political implications for each and every country.

Mrs. Cornell referred to the transfer to less risky markets of credits in the face of financial turmoil. While not intending in any way to cast doubt on the veracity of her argument, I would like to highlight the other side of the coin. That is, the prevailing interdependence and globalization have made it all but impossible

to take refuge on the highlands and stay immune from tornadoes. In different parts of the world, people went to bed one night and woke up the next morning to the news that overnight they had lost their entire life savings or their ability to make a living. Mr. van Heemstra cited various examples of this in detail, in particular when he described the living conditions of an Indonesian family.

At any rate, this is just the tip of the iceberg, and worldwide recession looms large on the horizon if we procrastinate. This has been highlighted by various panellists and speakers today. We are all in it together. This understanding could serve as a common denominator in our collective search for durable solutions, while it would be needless to emphasize that the exercise should be objective and bias-free.

One of the major causes of the financial crisis was the severance of the link between capital and production

The existing international financial system suffers from a good many inherent flaws and we should not turn a blind eye to them. For instance, one of the major causes of the recent financial crisis was the severance of the link between capital and production. The purpose of money is no longer to generate development or productive activities, but rather to generate more money. In the absence of such a crucial link between capital and productivity, we are far from achieving sound and sustained development and the chances of financial turmoil and its snowball effects are greater. We need to re-establish the correlation between rent of capital and rate of productivity, which is one of the features of the Islamic banking system. This would also contribute to a balanced distribution of investment worldwide, thus providing development opportunities to all nations based on their comparative advantages.

In addition, there exist no regulations on portfolio investment. As noted by the representative of Indonesia in New York, investors come and go as they wish, without the slightest heed to the consequences for the host country. It has been proved that market

forces alone cannot regulate speculative flows; they need to be regulated and an agreement on a capital moratorium should be negotiated. Meanwhile, a lender of last resort should be available, to bail out countries in need of continuing development, but not to nationalize private debts.

Speculative flows need to be regulated and an agreement on a capital moratorium should be negotiated

In conclusion, I agree with Ambassador Asadi that there is no unique panacea or development model for all countries. Models – in the plural – must be compatible with national circumstances.

REPRESENTATIVE OF SAINT LUCIA [New York]

I would like to register the appreciation of my delegation for this meaningful dialogue. I have noticed that most of the analysis and dialogue has focused on developed countries and on emerging economies, but there is still a forgotten category, that of the small vulnerable economies, into which we fall. I do not think I need to make a dramatic plea to make the point that we are still very marginalized.

There are so many aspects to the financial crisis and the effects of globalization and trade liberalization that every time there is a dialogue in a different forum, new perspectives are given. We heard today of good practices, and what countries are doing or what they are not doing or what they should be doing. The complexity and multiplicity of issues involved reinforce the need for a convergence of all dialogue in a universal forum like the United Nations to put in motion a process for the formulation of a framework for the global management and regulation of monetary matters. The framework need not necessarily be a global institution, as Mr. Hormats pointed out, but could be a framework of regulations, principles and procedures. As Mrs. Cornell said,

there are certain basics that apply worldwide when one is investing, and since we have achieved agreement on many international matters, there is no reason why we should not reach agreement in monetary matters, which are so fundamental and affect everything else. As this is a serious global problem, the solution should be global, with global participation; otherwise, what we have at the end of the day will not be sustainable or adequate.

A framework of regulations, principles and procedures is needed for the global management and regulation of monetary matters

REPRESENTATIVE OF BENIN [New York]

I would like to thank and congratulate those who took the initiative to arrange this video conference. I support what Mr. Ali said, particularly when he said that Africa does not have the means to guarantee the security of capital. I was surprised to hear Mrs. Cornell say that sub-Saharan Africa attracted more capital than Asian countries. This may be true in the case of some specific enterprises, but it is certainly not a general trend, because sub-Saharan Africa is considered by private investors as a high-risk area for capital investment, and countries like Botswana are isolated cases. One of our objectives should be to help African countries, most of which have been suffering from structural adjustment programmes, to build their infrastructure and to carry out the necessary reforms to attract foreign direct investment, so as to stimulate growth in Africa and reduce the marginalization of the continent in the globalization process.

One of our objectives should be to help African countries to build their infrastructure and to carry out the necessary reforms to attract foreign direct investment

Generally speaking, private capital is profit-oriented and seeks profit in the short term. When we see the decline in development assistance and hear ideas about promoting development through trade and private investment in line with market principles, we wonder how we can reconcile this search for profit with the concerns for development, namely, the reduction and eradication of poverty and meeting the vital needs of human beings.

REPRESENTATIVE OF YEMEN [New York]

I would also like to thank Mrs. Cornell for her comments, and I hope that she will soon turn her attention to our country, as a possible destination for investment. Some important ideas have been put forward today which would not have been aired without this exchange of views; they suggest that there is a way out of the crisis if we use a variety of responses and solutions. The content of some of the ideas expressed will no doubt be reviewed in other forums, but I would like to stress here that we do not want to limit capital flows, particularly since they are needed to assist developing countries in protecting their infrastructures. We have seen an unusual movement of capital – tens of billions of dollars in the space of few hours – and this is more than we can deal with;

Some aid must be given to developing countries to strengthen their institutional capacities to deal with the ripple effects of the Asian crisis

we need the creation of national institutions to protect ourselves without impeding the flow of capital. We think that the most recent dialogue on globalization and the effects of the July 1997 crisis have led to calls for measures that are not habitual in our countries, while we, in our country, are trying to avoid marginalization and participate in the world economy. So some aid must be given to developing countries to strengthen their

institutional capacities to deal with the ripple effects of the Asian crisis.

Finally, we think that one of the solutions to this crisis is transparency. However, if we achieve transparency from all partners, we should not forget that, in the case of the developing countries, we need to take into account local characteristics and factors for social stability as we try to resolve the financial crisis which is affecting the global economy and which has proved that the world economy is entirely interdependent.

MRS. JOYCE E. CORNELL [New York]

I would just like to respond briefly to the representative of Benin. First of all, I just mentioned a few of the African countries we have invested in – I'll extend the list in a second – but Scudder and some other investors are actually putting more money into Africa. To clarify the point on Asia, Scudder right now has more money between the Limpopo and the Sahara than it has in Asia. What the future holds is in your hands, fundamentally. We will, I am sure, eventually have money going back into Asia, but we see a lot of interesting things happening in Africa. We have quite a lot of money in Malawi, and we like very much the idea of a particular investment in the United Republic of Tanzania, but we are having trouble there on the regulatory front. We also have a tiny indirect investment in Eritrea.

In one sense, it is true that we want a short-term profit, but the ideal investment, when you are investing pension money, and that is most of our money, is one that works for a long time. People start planning for retirement long before they retire, and once they retire they hope to have a long, happy and healthy retirement, so you are looking at a long horizon here. Since this kind of investment is difficult to trade, expensive and cumbersome, it is just better to find a good investment and live with it. For us, the ideal investment gives us the return we want in ten or twenty years. So this is not necessarily short-term; it is only short-term if the management makes major mistakes or if there are other cataclysmic

events that make you think, "this is not going right, this is going to spoil someone's retirement" – then you move. But the ideal is not short-term but long-term growth.

I do want to make one comment for the benefit of the representative of Yemen. Actually, we are watching what Yemen is doing with very great interest. Our Arab analyst has been there and we were encouraged by what we saw; we are actually in the process of making an investment there indirectly, through an Egyptian company of which we own a major portion. So that is our first entrée, but we are very hopeful that it will not be too long before the structural situation is such that we can invest our pension money in Yemen directly out of New York.

CHAIRMAN

I would like to take this opportunity to thank all the panellists, speakers and delegates in New York for their valuable participation. I would also like to thank our panellists here in Geneva for their highly interesting contributions to our discussion today. I would like to end by saying that after this one day of discussions, I do not think we can reach definite conclusions, but now that we have gathered information from sources really involved in the crisis, it seems to me that when we are looking for

We need to address the issues of trade, finance and development together: they cannot be addressed in isolation

a solution to the crisis we need to address the issues of trade, finance and development together. They cannot be addressed in isolation. There is a need for a global action, but there is also a need for domestic, rational action. We should also not forget those continents and countries far away from the crisis that still have to carry out their own structural improvements – I am thinking particularly of the African continent – and we should not

let the crisis marginalize these countries even more than they have been in the past. We should be working, for example, on certain programmes to alleviate the debt problems of these countries.

I would also take note particularly of the need for the ripple effects to be contained; we need to stop this contagion from spreading, particularly to those countries that have not yet been affected by the crisis, so that ultimately we can all come out of this crisis together.

I would now like to give the floor to the Secretary-General of UNCTAD, Mr. Ricupero, for the last word.

MR. RUBENS RICUPERO

Let me just say that this debate has once again demonstrated the correctness of insisting on integrating civil society in the United Nations system, particularly in the case of UNCTAD. You know that I am a strong believer in this concept, and the exercise we have had today has shown the richness and diversity of the concrete proposals made by representatives of small, medium-sized and large companies, trade unions and the regional commissions of the United Nations. I do not think it would have been possible to have so many interesting and enriching suggestions if we had limited ourselves to a governmental debate. I have been going for many years to the joint IMF and World Bank meetings and, although they are extremely interesting, we never had the benefit there of the presence of people who actually work in the market, like Mrs. Cornell and Mr. Hormats.

The integration of civil society in the work of international organizations is an issue that needs to be taken very seriously. One of the reasons for the crisis in international organizations is their failure to deal effectively with this issue, and I would not accept the argument that debate in itself does not solve anything, and that it is only tokenism to give people the floor if they cannot make decisions. We have to bear in mind that, in international matters and in politics in general, communication, words and discussion are part of the solution – as they are in psychotherapy, where you

have to speak about your problems in order to solve them. As we saw today, the international economy is to a large extent a matter of psychology. When people speak about the dangers of a repeat of the great depression of 1929, what they forget is that before the stock exchange crash, there was no debate like the one we have held today in New York and Geneva. To talk about the danger is a way of exorcising the danger, because history is a process of learning. As I have already said many times, Mr. Greenspan, the Chairman of the United States Federal Reserve, is the wisest man in the international economic arena. In October 1997, he refloated the stock exchange because he had to guarantee the liquidity of the system, and now he is trying to do it again. So, people do learn from experience and we need to speak about their experience in order to avoid the mistakes of the past.

A financial crisis is like an earthquake: the countries at the epicentre are devastated and the ripple effects travel far and wide. In the case of the 1997 Asian financial crisis, this analogy has proved only too apt. Over a year after the event, the countries at the epicentre are still coping with the aftermath, while others are looking for ways to limit its damaging after-effects. But so far, few authoritative answers have been found to the two main questions raised by the crisis.

What caused the crisis in the first place?
And what can be done to avoid similar crises in the future?

Over a year after the event, some tentative answers to these questions are beginning to emerge. This book contains the thoughtful analysis and practical suggestions of first-hand witnesses from large and small companies caught up in the crisis, business and investment experts, representatives of the United Nations regional economic commissions and representatives of the Governments the world looks to for action.

There is no magic solution to the problems created by the Asian crisis, but the high-level discussions organized by the **United Nations Conference on Trade and Development** and reported in this book go some way towards identifying our past mistakes and will help us to avoid making the same mistakes again.